Statement of Calvin Bradford,
President, Calvin Bradford & Associates, Ltd.
Before the Public Hearing on the Community Reinvestment Act Regulations
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Thank you for the opportunity to file these comments on the development of revised regulations to implement the Community Reinvestment Act of 1977. This is a moment of great opportunity for the financial regulatory agencies. We have seen our government bail out the big banks and Wall Street with hundreds of billions but no accountability for the Great Recession that they created. Now the executives on Wall Street and in the banks are retuning to their high salaries and benefits, but not enough loans are not flowing to main street and consumers to reverse unemployment and stabilize the economy. Meanwhile, payday and title lenders and mortgage rescue scam artists are preying on the victims of The Great Recession.

The Reinvestment Act is an underused federal resource - created by the people and for the people – that was specifically designed to hold financial institutions accountable for serving consumer and business credit needs in return for the deposit insurance, loans, investments, and protection from competition that the government provides to financial institutions. It empowers the financial regulatory agencies to hold lenders accountable for serving the needs of all Americans, especially in areas where the economies are depressed – as they are today across so much of the land. In short, the Community Reinvestment Act is the one government program specifically designed to ensure reinvestment in local economies when they are in need, to ensure fair access to credit and financial services, and to spur innovation and creativity in economic development. Moreover, it was designed to allow citizens to participate directly in their own community economic development. Through partnerships of the community and financial institutions trillions of dollars of sound investments and loans had revived lagging economic communities and sustained development for decades. TARP was all about Wall Street – the Reinvestment Act is all about Main Street.

Those of us who have worked for reinvestment and fair lending over the past decades are hopeful of this plan to revise the regulations – but we have good reason to be skeptical. Over the years, the enforcement effort – which was not aggressive in the first place - has deteriorated, giving over 95% of all regulated institutions passing or outstanding grades while many of the most powerful institutions were sowing the seeds of destruction of the very communities they were charged with serving.

It is time for the regulators to stop singing the "no one could have foreseen the meltdown" refrain. For over a decade, reinvestment, civil rights, and consumer groups have been warning of the dire impacts of the subprime market, particularly in terms of its destruction of low- and moderate-income and minority communities. HUD and Treasury produced their own studies and warnings on predatory lending in 2000. The regulatory agencies have issued repeated warnings about abusive lending practices. I have attended community meetings with all of the regulatory agencies together where the warnings

were sounded and the passive role of the regulatory agencies was challenged. The coming crisis was not simply a vague shadow, it was the 500 pound gorilla in the room. For all the anger heaped on the Wall Street investors and mega banks, it was Congress, past Administrations, and the regulatory agencies that allowed the financial crisis to grow into a world crisis. On the other hand, many, generally smaller, lenders who did serve the needs of their communities have simply been dragged under by the financial meltdown caused by Wall Street and their big banking colleagues.

It is time for the regulatory agencies who rescued Wall Street and the big bank holding companies to step up and renew these reinvestment regulations by holding financial companies accountable for serving the needs of American consumers and businesses and by reasserting the role of the public in the reinvestment process.

I have arranged my comments in three sections. The first section is an introductory statement that provides a context for my recommendations. The second section is a summary of key and recommendations. I have regrouped the issues defined under the headings of the Topics and Questions that accompanied the notice of these public hearings under three overall categories – accountability, community development banking, and public participation. The third section provides an historical background to support my recommendations. While there are many topics and issues that can be reviewed in light of the history of the CRA regulatory process, this background is particularly focused on the nature of assessment areas, the assessment of discrimination, and the inclusion of all affiliates of holding companies in the assessment process.

Section 1: The Context for Revising the Reinvestment Regulations

Aside from the act of voting, citizens have few opportunities to participate directly in public policy. The role originally given to the public in working with lenders and in challenging covered activities is one of the rare places where citizens can participate in the economic policies and practices that affect their lives and their communities. This focus on modernizing the CRA regulations to meet the demands of the modern financial marketplace, should remind all of us of the incredible accomplishments that have come from trillions of dollars in reinvestment in low- and moderate-income and minority communities through the efforts of community-based organizations and development corporations in partnerships with local, regional, and national lenders. Over the years, however, revisions in the CRA regulations have weakened and undermined both the enforcement process and the role of the public and community.

The Community Reinvestment Act was passed more than 32 years ago. It has a long history both in terms of the legislation and the implementing regulations. It also has a parallel history in terms of community economic development and development banking which is often overlooked. Personally, I have had the pleasure of working on both the community and development banking branches of this reinvestment history.

Aside from working on the original drafting of the CRA, I have provided formal reviews of individual CRA programs (such as the Chicago Reinvestment Partnership) and I was the director of a systematic cataloguing and analysis of CRA agreements funded by the Ford Foundation. I served as the contractor with the regulatory agencies on a unique study of the experience of the CRA in rural areas. I have conducted several of the analyses of lending patterns and fair lending issues at both the state and metropolitan levels for the Analysis of Impediments to Fair Housing required by HUD for Community Development Block Grant and other entitlement fund recipients. These experiences not only defined CRA issues, but they focused on the creativity of both the banking institutions and the community and technical assistance providers in ways that I believe provide a valuable basis for balancing regulatory accountability with flexibility in the assessment process.

On the applied side, I have worked with many different local community and development organizations. I have drafted community handbooks on the CRA. I have also served as a consultant to major mortgage lenders, providing me with an in-depth understanding of both the retail and wholesale lending markets from product development to servicing. On the enforcement side, I have worked on several challenges, including the only CRA challenge to an acquisition that resulted in a unanimous rejection of an application by the Federal Reserve Board. I have been asked to testify on CRA issues several times before Congressional committees in both the House and Senate. On the important question of the inclusion of race in the CRA regulations, I have been an expert in over sixty lending cases involving fair lending and unfair and deceptive trade practices in both mortgage and automobile financing.

Any serious effort to revise the CRA regulations to meet the demands of the current financial markets needs to be placed within the context of the past legislative and regulatory history. For the much simpler financial markets in which it was developed, the Reinvestment Act was designed to assure fair access to credit to all persons and all communities and to serve as an engine for the creation of a development banking industry. Over the years since the Act was created, the markets have become more complex and simultaneously both more segmented and more fragmented. As the regulations for the Act have become more diffuse and lax, neither of the original goals of the Act is now being met.

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

In the current meltdown, any admission of culpability by the Wall Street and banking investors falls under the rubric of failing to hedge fully and soundly the risks resulting from their investments in unsound and toxic loans. In response, the structure of the regulatory reform efforts (aside from the effort to create the Consumer Finance Protection Bureau [CFPB]) are aimed largely at ensuring some form of proper hedging (insurance, reserves, etc.) – rather than at controlling the development or use of potentially toxic financial products. Increased capital requirements, after all, are basically a form of hedging, but in a different form than a credit default swap. In any event, the purpose is to protect the investor from the consequences of the investment and not to protect the public from the investment itself.

The present support for community investment – which is really about getting the money to Main Street – rests on an uneven four-cornered foundation. First, in reality, regulation is focused on minimizing losses to the investors, whether they are banks, investment houses, insurance companies, or some hybrid. Second, it is the proposed and, as yet nonexistent, Consumer Finance Protection Bureau that would focus on identifying and, in some cases prohibiting, the use of products that are deceptive, misleading, or that are potentially toxic to either individuals or communities. Third, the Community Reinvestment Act, with outdated and poorly enforced regulations, is left as the main vehicle to provide fair access to sound financial products while holding financial institutions accountable for the impacts of toxic financial products. The fourth foundation block is the fair lending laws with varying rights and responsibilities spread across different regulators and agencies with little cooperative effort and sporadic enforcement histories. Meanwhile, most fair lending activities are left to the limited resources of private enforcement groups and attorneys. The modernization of the CRA regulations, therefore, needs to face this reality.

Section 2: An Overall Focus on Accountability, Community Development Banking, and Public Involvement

Accountability

Fair Access to Credit:

The first act of accountability for the Reinvestment Act regulations should be a fair access to financial services test. These laws are so basic that evidence of fair lending violations (aside from minor correctable technical issues) should result in automatic failure rating.[1] No revision of the regulations can be taken seriously if it does not aggressively hold lenders accountable for fair lending.

When the CRA was passed, the legislators convinced the public supporters that fair lending was so clearly required by the Equal Credit Opportunity Act and the Fair

[1] As I have noted in the background section, such an action was recommended by a HUD study prior to the development of the original CRA regulations and by the Consumer Advisory Council during the revisions that led to the 1995 regulations.

Housing Act that no specific antidiscrimination provisions needed to be included in the Act itself.[2] In the original regulations, there were specific assessment factors for assessing possible discrimination. In 1995, at the beginning of the growth of the subprime markets, the anti-discrimination assessment factors were eliminated. Meanwhile as mortgage lending spread from direct depository lenders to affiliates, the fair lending exams actually prohibited assessing the full record of all holding company affiliates.

The mortgage meltdown began with the exploitation of the very minority and low- and moderate-income borrowers and communities that the Reinvestment Act was designed to protect. These borrowers and communities did not cause the financial meltdown, they were its first victims. Long before the growth and bursting of the housing bubbles in the middle-class and higher-income growth areas, subprime lenders tested and perfected their models and marketing of their toxic products in the most vulnerable communities and on the most vulnerable borrowers. In spite of many public pronouncements, studies by HUD and Treasury and a plethora of community, fair housing, public interest, and consumer groups showing the racial disparities in subprime and predatory lending, CRA exams continued to reward lenders for concentrating toxic products in minority markets and to ignore the lines of credit and wholesale lending by the large banks that supported the independent subprime and payday lenders.[3]

Had the regulatory agencies revised their fair lending exams and CRA exams to hold lenders accountable for these discriminatory and exploitive activities, the mortgage meltdown that grew to undermine the entire economy might have been largely averted. The failure to enforce fair lending laws directly and through the CRA was a major part of the overall regulatory failure that created the Great Recession.

<u>Assessment of Both Positive and Negative Activities:</u>

The Reinvestment Act regulations need to recognize that the obligations to serve communities in a safe and sound way require not only credit for positive activities, but penalties for unsound, exploitive, and toxic products – and especially the concentration of these products in certain communities and markets.

In the future, the Consumer Finance Protection Bureau may provide some essential parameters for defining unsound, exploitive, and toxic products. In addition to the definition of specific products in and of themselves, however, the Reinvestment Act regulations need to assess how various products are used. The use of high risk loans, even if the product may be valuable to certain selected borrowers in certain limited situations, would represent an abusive practice if these loans were unduly concentrated in certain neighborhoods where the higher expected loss rates could significantly undermine the property values or the overall financial stability of the residents.

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[2] These issues are reviewed in detail in the background section of this statement.

[3] A detailed analysis of these failings can be found in the background sections of that statement.

In addition to direct lending practices, the Reinvestment Act regulations need to consider the impacts of financial services that support abusive, exploitive, and unsound lending. For example, the wholesale activities of providing investment capital or lines of credit to payday lenders or to subprime lenders engaged in abusive lending practices also represent activities that should be reviewed as potentially negative.

Finally, the Reinvestment Act regulations need to formally include in the assessment factors for discrimination a review of the financial services patterns of all the affiliates within the CRA geographic assessment area to ensure that it does not exclude either low- and moderate-income areas or racially diverse and minority areas. This review would include the locations and range of services for actual depository facilities. Exclusion of these racial markets by any affiliate should also result in an automatic failing grade.

Inclusion of Affiliate and Affiliate Activities:

Any meaningful revisions to the Reinvestment Act regulations need to recognize that where bank holding companies are involved, products and services are provided strategically through different holding company affiliates. Therefore, no picture of compliance is complete unless it necessarily includes all of the affiliates of the holding company.

Since holding companies often engage in mortgage and consumer lending by segmenting or channeling different products through different affiliates, the assessment of any particular form of lending (mortgages, small business lending, consumer loans, credit card services, etc.) needs to require the inclusion of all the affiliates that engage in that type of lending or banking service.[4]

We can see in the present foreclosure crisis that key financial services involve not only lending and investments but also the servicing of loans. It is important that servicing activities be covered by the Reinvestment Act assessments whether done by the depository institutions, direct subsidiaries, or holding company affiliates. Developing regulatory standards for what constitutes sound servicing will also help define important servicing contract provisions in the future.

These lending and servicing requirements will have far reaching impacts for fair lending examinations where a review of affiliates (as opposed to direct subsidiaries) is presently prohibited. In addition, effective review of fair lending will require coordination with the Consumer Financial Protection Bureau in its fair lending activities as well as the review of the existing efforts at coordination with HUD and the Department of Justice.

Finally, moving to a single assessment including all affiliates will require coordination with the different financial regulatory agencies as well. Developing a

[4] The background section of this statement reviews in detail an example of how different the service record of a lender may look depending upon which affiliates are included in the review.

unified assessment of all the holding company affiliates – especially where some affiliates may be regulated by different agencies – represents one of the most fundamental challenges to a serious and meaningful revision of the regulations.

One approach could be allocating the full assessment to a single regulatory agency (such as the agency that regulates the largest depository institution). A second option might be the creation of an assessment team that is trained in a uniform way and that represents the agencies collectively. This team would be able to integrate all the affiliate activities into a single overall assessment (while still noting any individual discriminatory activities by a single affiliate or depository). A third option could be adopting some form of a coordinated assessment that combines the individual data and analyses from different agencies. In such a combined approach, findings of evidence of discrimination for any agency in any part of the examination should constitute a finding applied to the full holding company assessment. This third option risks the continuation of the segmented approach that presently fails to account for a unified assessment of the overall patterns and activities of all of the affiliates collectively.

Geographic Coverage of Assessment Areas:

For many depository institutions or bank holding companies, the majority of their lending, investments, online deposits, and servicing of loans takes place outside of the present assessment areas – often in markets where they may be one of the dominate players. Therefore, in addition to including all affiliates, the modernization of the Reinvestment Act regulations needs to define assessment areas so that all lending and financial services are included in some form of an assessment area. One option I propose is to define one set of assessments areas for geographic areas served by bricks and mortar depository facilities (Direct Banking Assessment Areas) and another set of assessments (Assessment Regions) for geographic areas served by one of more affiliates outside of these direct banking assessment areas.

Where a bank holding company has actual physical depository facilities, assessment areas should be defined around these facilities. Where these assessment areas are not defined by the holding company as complete counties or metropolitan areas, they must be defined in ways that include contiguous areas around the facilities.

Outside of these depository bricks and mortar assessment areas, assessment "regions" can be identified. These areas would include at least full counties, metropolitan areas, a whole state (outside of any bricks and mortar assessment areas), or contiguous regions within more than one state. A measure such as 0.5 % of market share and contiguous areas (as proposed in HR 1479, the present CRA Modernization Act) seems reasonable.[5]

[5] This bill also uses a standard of where the "great majority of loans have been issued". This might not work for a lender that made loans in several metropolitan areas across the country outside of the existing assessment area, for example, where the metropolitan areas are clearly not contiguous. It would be better to define each such metropolitan area as an "assessment region".

In both types of assessment areas, all of the affiliates of a bank holding company operating in that area would be included in the assessment. As in the case of the fair lending examinations, where multiple financial regulatory agencies are involved in the regulation of different depository institutions within a holding company, a process would need to be established to define a single agency for the holding company assessment or some collective or cooperative process to produce a single holding company assessment and rating.

The Reinvestment Act Assessment and Rating Process:

The existing assessment and rating process has become a pedantic and uncreative process of tallying up loans and program dollars focused on limited service areas and selective affiliate activities. In order to match the Reinvestment Act assessment and rating process to the present structure and activities of the financial markets of bank holding companies, the entire process needs to be restructured. The present financial crisis has shown us that there needs to a more transparent and clear process for accountability while allowing for more flexibility to both address the varied patterns of holding company activities and to more directly encourage and reward community development activities.

I would recommend the following overall restructuring of the assessment process and rating system:

I. Apply a fair lending/investment/service test to each assessment as a precondition for a passing grade.

A. Assessments should be based on all of the affiliate activities within either the Direct Banking Assessment Area or the Assessment Region.

B. Evidence of discrimination activities in any affiliate within the assessment area or region should result in an automatic failing grade.

C. In failing on a fair access to credit review, lenders should automatically be placed on probation for the use and servicing of government-backed loans and loans sold to the GSEs (FHA loans, Veterans loans, Rural Housing Services loans, SBA loans, etc.).

D. The failing affiliate should be subject to an improvement plan during the period of probation.

E. The merger and acquisition activities of the holding company should be suspended until the affiliate on probation has completed its improvement program and a new passing rating has been issued.

II. The rating factors, tests, and weighting of the factors should be subject to adjustments for the type of assessment area and the range and capacity of the affiliates involved.

A. Bricks and mortar assessments are generally going to include more primary consumer and business lending and depository service activities than are regional assessments, where direct and affiliate mortgage lending is more likely to be dominant, if not the single assessment factor.

B. The scoring system needs to be expanded (from 24 overall points to something like 100 points) so that there is enough flexibility for giving due credit to different areas where a particular lender may serve a unique or important niche.

C. Assessments need to include both penalties for negative activities as well as points for positive activities.

D. Assessment and ratings need to be subject to more public involvement with additional roles for challenging covered activities, performance issues between examinations, and the ratings themselves.

E. The role of community development needs to be enhanced by restructuring the assessment tests and adding a special community development test, as described below.

Linkage to Critical Periodic Market Conditions Needs

Over time there have been critical economic issues that are pervasive across the national economy or across a wide range of local markets. Often these issues are particularly related to the impacts of activities related to covered institutions. For example, the regulatory agencies have issued policy statements about subprime lending abuses, payday lending, and loan servicing and modification. These policy statements actually identify specific and pervasive credit or servicing issues and needs. Therefore, in order to have a meaningful impact, these policy statements should have a direct link to both ongoing assessments and to challenges to the operations of covered institutions and affiliates between assessments.

For example, the foreclosure crisis impacts communities all across the nation. The responsiveness of servicers to the needs of troubled loans has an important impact on communities where troubled loans are located. Where servicers that are part of covered institutions have failed to respond properly, fairly, and appropriately, these issues should become part of the current assessment process and subject to significant challenges by the public. On the other hand, lenders making aggressive and creative efforts at loan modifications and foreclosure prevention should be rewarded.

A similar case can be made in relation to payday lending, for example. Lenders that are providing their own forms of payday loans or that are providing investments or lines of credit to abusive payday lenders should be subject to downgrading of their CRA ratings. Lenders that have developed small loan balance products that can provide alternatives to payday loans or that can rescue borrowers from payday loans should receive CRA credit for these activities.

Therefore, from time to time, the regulatory agencies (on their own or in response to evaluations from the Consumer Finance Protection Bureau) should not only issue policy statements, but they should indicate the ways in which these policy statements will be linked to CRA assessments and challenges.

Community Development Banking Activities

In order to encourage community development activities, to provide for more creative activities, and to help establish a base of lending and investment activities appropriate to each institution, a new rating category for economic development activities needs to be established and integrated into the rating process. While an institution or holding company might receive a passing grade without such activities, Outstanding grades should be reserved for institutions that raise the bar on reinvestment. Of course, credit needs to be based on the capacity and resources of the institution or holding company so that middle and smaller sized institutions (in particular) receive full credit for appropriate activities.

For many institutions, particularly larger institutions, basic forms of affordable housing loans or investments (mortgage pools, NeighborWorks programs, affordable housing loans for the GSEs. etc.) which were once creative and new reinvestment programs have become normal and routine activities. Routine lending and investment programs should receive positive credit under the lending and investment tests. Indeed, a lender with the capacity and resources to engage in these programs should not receive a passing CRA ratings without a level of participation in such programs commensurate with the holding company resources and capacity as part of the normal lending or investment test. But, once they have become routine, they should be separated from creative new efforts that provide loan programs, critical investments, or banking services that are still missing from the normal market.

Adding a special community development test would have several advantages. For example, it would increase the incentives for new community development efforts. In order to add substance to this category, I would recommend requiring a community development plan. The original 1978 regulations required institutions to assess local credit needs. I would recommend a revision of this requirement focused on community development activities that go beyond the existing and normal range of lending, investments, and service activities engaged in by the institution and the affiliates of the holding company.

In reviewing the activities of many medium and smaller banks, I have often been impressed with their detailed knowledge of local economic conditions and needs. In responding to the original CRA assessment factor requiring an assessment of the local credit needs, these bankers could easily take you on a tour of the community and point out where investments and loans were needed and what obstacles there were to responding to these needs. In essence, they had an assessment of the local needs and a realistic sense of the resources and constraints related to these needs. In most cases, these lenders had some creative ideas for ways to meet these needs. Under the CRA

assessment process, however, they felt constrained to focus on mortgage lending or routine small business lending in order to ensure enough points to get a satisfactory rating.

A separate category for community development would allow a more appropriate assessment of real community development activities and could provide for a much broader range of activities than the mundane loan counting. These activities might range from bringing together key players and resources to direct creative investments to developing a program of small dollar loans to rescue people from payday lenders and provide opportunities for personal financial security.

This category could also include programs and projects that create "green" jobs and contribute to sustainable environmental businesses. Such programs could be subject to special "bonus points" where the institution had demonstrated a base level of fair service to the community. This would encourage new forms of community development and reinvestment without the lenders having to worry over whether they would be counted or without having to seek individual approval for credit for each now idea. For example, a program proposed in Central Illinois would provide for the transfer of profits and benefits for developments in high growth higher income markets where some development income would be transferred to groups working in low- and moderate-income neighborhoods and where job training would provide employment for persons in these communities.

The required community development plans need not be complex assessments, but should be appropriate to the resources and sophistication of the holding company or individual institution involved. They can be as basic as defining the development activity, explaining the need it serves, and setting some goals for the activity. For smaller institutions, adding affordable housing programs that may be routine for larger institutions, for example, might be considered part of a community development plan.

Finally, this would create an assessment factor where formal reinvestment agreements recognized by both the institution and the public participants would be given a weight in the assessment process.

Public Participation

Historically, it has been partnerships between banking institutions and community groups or responses to CRA challenges that have created the models for the trillions of dollars of sound reinvestment over the past three decades. Essentially, the 1995 regulations and the treatment of challenges to the major acquisitions and mergers since that time have removed this creative tension from the reinvestment process. The modernized regulations need to reintroduce this significant public role in the process. This can be achieved (1) by providing improved disclosure, and (2) by providing a meaningful role for challenges and hearings on covered activities, ratings, community development plans, and ongoing performance.

One reason why so many creative mortgage programs have been created over the past decades is that community, civil rights, and consumer groups used the disclosure data from the Home Mortgage Disclosure Act to define underserved markets, challenge discriminatory or abusive lending practices, and create CRA agreements and lending programs to overcome these problems. Indeed, disclosure has been the keystone for reinvestment.

On the data disclosure side, there are two key areas. First there is the need the expand the CRA business loan data disclosure to include the census tract locations of the loans. Without this geographic link, it has not been possible for public groups to define either existing market patterns and needs or the roles of specific lenders. Both of these elements are critical to increasing reinvestment and putting loans in the hands of existing and new businesses.

Second, the parallel hearings on the expansion of the Home Mortgage Disclosure Act are critical in providing better information on home lending patterns and issues. While the banking reform legislation does include new HMDA data elements, it lacks data on servicing. Given the major problems in loan servicing and foreclosure that are continuing to undermine the housing markets and that are contributing to decline in many communities, we should have no trouble seeing what an advantage it would have been to have data on the locations and defaults and foreclosures and on the lenders and servicers who are involved with different levels of distressed loans back when the problems first began to emerge.

On the other hand, there is also a need for increased disclosure of the results of CRA examinations. This is especially true for the minimal statement related to evidence of discriminatory practices. We need to have disclosure of what examinations were done, when they were done, what loans they involved, and what were the results of the analysis.

The last issue, and surely not the least, is the need for a wider role for public challenges – not only to applications for mergers and acquisitions, but to existing lending patterns and to the CRA ratings themselves. Mergers and acquisitions (outside of those resulting from bank failures) are relatively rare today. If the public has concerns about the performance of a covered lender, there is generally no option other than placing a letter or comment in the CRA file – a process with virtually no impact.

Therefore, we need to allow for significant challenges to ratings and even to the existing performance of an institution or holding company between assessments. The revised regulations should have a process for appealing a rating and a mandatory hearing on applications where there is a significant challenge. Significant challenges to community development plans and improvement plans for failing institutions should also be afforded a hearing or formal specific review process with a public disclosure of the results.

It may be that the regulators believe that they could not have seen the coming financial meltdown, but the community groups have seen it coming since the late 1990s. Had they been given a fair hearing and better data and support for their own reviews, our communities might still be vibrant and alive from the decades of reinvestment instead of being dragged back into decline by the abuses of the lenders and investment community.

Section 3: A Review of the Historical Context for the CRA

The Legislation

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

Running parallel to and in concert with the movement against redlining was the reinvestment movement seeking to build private lending programs to reinvest in the communities that had been redlined. While the World Bank and other foreign aid programs were designed to support economic growth in third world economies, there was no real program in the United States to support reinvestment by the private financial institutions in the disinvested communities that existed in depressed rural areas and in so many inner city communities. The reinvestment movement saw the need to develop the investment, lending, and programmatic skills necessary to revitalize disinvested communities. Together, community action groups, the growing base of community-based development corporations, and the South Shore Bank, in particular, provided both a political base for action and sound practical applications as support for making reinvestment part of the banking business. One indication of the breadth of this movement was a conference held in Chicago in the fall of 1976 under the title "From Redlining to Reinvestment", sponsored by the Governor of the State of Illinois for members of other state governments and community-based organizations to define their role in dealing with redlining and disinvestment issues. Representatives from across the nation from California to Massachusetts, participated in reviewing different programs designed to build a development banking industry in lagging local economic areas. Conference organizers included the South Shore Bank, the Woodstock Institute, and the Center for Urban Affairs at Northwestern University.

The Community Reinvestment Act (as Senate Bill 406) was the product of interactions between legislators, officials of the South Shore Bank in Chicago (a

community development bank), and leaders of the anti-redlining movement – especially the National People's Action (NPA) led by Gale Cincotta, of Chicago. The CRA was based on the existing laws covering financial institutions that are chartered by the Federal government and/or that receive the substantial benefits and protections of deposit insurance. As Senator Proxmire noted in a letter circulated in December of 1976 with a draft of the CRA bill:

> The authority to operate new deposit facilities is given away free to successful applicants even though the authority conveys substantial economic benefit to the applicant. Those who obtain new deposit facilities receive a semi-exclusive franchise to do business in a particular geographic area. The government limits the entry of other potential competitors into that area if such entry would unduly jeopardize existing financial institutions. … The government provides deposit insurance through the FDIC and the FSLIC [Federal Savings and Loan Insurance Corporation] with a financial backup from the U.S. Treasury. The government also provides ready access to low cost credit through the Federal Reserve Banks or the Federal Home Loan Banks.
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> In return for these benefits, financial institutions are required by law and regulatory policy to serve the "convenience and needs" of their communities as a condition for acquiring new deposit facilities. … However, in practice, the regulators have tended to ignore credit needs and have focused primarily on deposit needs.[6] The regulators have thus conferred substantial economic benefits on private institutions without extracting any meaningful quid pro quo for the public. … The proposed legislation directs the bank regulatory agencies to use their leverage in approving applications for deposit facilities in a way that will benefit local communities. … **The bill would not inject any radically new element into the deposit facility application and approval process already in place. Instead, it merely amplifies the "community need" criteria already contained in existing law and regulation and provides a more explicit statutory statement of what constitutes "community need"** (emphasis added).[7]

Therefore, the CRA was based on the existing processes for granting charters or approving acquisitions, mergers, and branching – and on the clear assumption that these activities are not a right, but are a privilege. Indeed, a citizen's group had already challenged the application of the South Shore National Bank to move from its existing minority neighborhood in Chicago to a location in the downtown "Loop" area. By showing that existing need for the bank in its existing community and the strong deposit and potential lending base, this community challenge resulted in the denial of the application and the subsequent sale of the bank to the community investors who turned the bank into the model for Community Development Financial Institutions.

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

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

The Community Reinvestment Act was intended to ensure that all banking institutions that failed to meet the convenience and needs of their local communities would not be eligible for these financial privileges. Certainly, today we understand the magnitude of the protections provided to these financial institutions. While the government has spent billions saving the financial institutions, it is really the Community Reinvestment Act that is the vehicle to ensure that, once rescued, these financial institutions invest soundly in the development and growth of Main Street. The lack of these investments in our local communities and economies is leaving us with a jobless recovery – if not dragging us into a deeper recession. It is time to take seriously the quid pro quo for all the protections granted by the taxpayers to the financial industry.

At the heart of the anti-redlining movement, of course, was the elimination of racial redlining and discrimination in lending. As I have detailed in other sections, below, while the community groups working on the CRA considered it crucial to include non-discrimination in the language of the CRA, the legislators convinced them that it was superfluous to specifically include race because the Equal Credit Opportunity Act (ECOA) and the Fair Housing Act clearly placed anti-discrimination requirements on the individual lenders and either the laws or executive orders placed an affirmative obligation to further fair lending on the regulatory agencies.

On the other hand, moderate- and lower-income communities were not specifically protected from discrimination or disinvestment by existing laws. Therefore, the Act did specifically require that lenders serve the needs of low- and moderate-income communities.

The Act stated that the lenders had a "continuing and affirmative obligation" to serve the needs of their communities. A clear role was created for members of the public to challenge applications for mergers, acquisitions and branches.

Progress on Reinvestment

When it became clear that neither the regulators nor the banking industry – both of whom had opposed the legislation – were making significant efforts to hold banks accountable for programs to reinvest in underserved communities, community-based organizations and development corporations initiated their own reinvestment loan programs and challenged the lenders to participate. Together, community action groups, the growing base of community-based development corporations, and the South Shore Bank, in particular, provided both the motivation and models to support making reinvestment part of the banking business. Today, there are many different and successful CRA programs and a specialized community development financial institution sector, virtually all of which are variations of models first developed by community organizations in partnership with financial institutions.

While we have several programs to funnel private investment into lagging economic markets in foreign countries, the Community Reinvestment Act remains the

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

The efforts to build a more pervasive development banking industry have been frustrated in part by the fact that these agreements have never been recognized as formal obligations by the bank regulatory agencies and neither the regulatory agencies (including the Treasury Department), HUD, nor the Department of Commerce have ever taken seriously the role of building an economic development banking industry in the national economy.[8]

The Regulatory Record

Discrimination, Redlining, and the Initial Regulations in 1978

"Now you see it, and now you don't" may be the best way to describe the CRA protections against racial discrimination in the regulatory process. There is clear evidence that community groups were not alone in their assumption that racial discrimination was an essential part of the CRA and its enforcement.

Immediately after the CRA was passed, HUD had contracted for a report on the likely impact of the CRA. The report includes sections on what the examination process should look like and what types of resources should be used in the examination process. At the beginning of the section on the examination of the institution's record is the statement, "The first almost elementary aspect of any assessment should be an evaluation of the lenders (sic) record under the Fair Housing Act, Equal Credit Opportunity Act, and related non-discrimination regulations. A lender in violation of these provisions is, *a priori*, not meeting the needs of his community" (emphasis added).[9]

[8] While we note the critical role played by Community Development Financial Institutions, isolating the skills and experience of such lending in separate institutions where the regulated lenders and the government provide support is not a replacement for the larger banking industry, itself, acquiring and developing these skills and this experience. Moreover, during my work on rural CRA compliance, I found that many small independent banks acted as a development engine for their local economies in ways that were not easily reduced to the assessment factors of the present CRA ratings process.

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

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

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

Unfortunately, from the issuance of the first implementing regulations in October of 1978, there was evidence that the regulatory agencies would not require lenders to define their local community definitions in ways that would ensure the elimination of racial redlining.[10] These regulations provided for three ways of defining the local community area. The first method required using existing boundaries, such as entire Metropolitan Statistical Areas (MSAs) or counties. If an institution chose this method, it would typically avoid redlining. The second method allowed for defining the local community reflected some of the *general concepts* in the draft CRA legislation by providing for a local community defined by the institution's lending patterns. In this case, the institution was to delineate an "effective lending territory" defined as "that local area or areas around each office or group of offices where it makes a substantial portion of its loans and *all other areas equidistant from its offices as those areas*" (emphasis added). On the other hand, there was also a third option where the institution could "use any other reasonably delineated local area that meets the purposes of the Community Reinvestment Act and does not exclude low- and moderate-income neighborhoods".

The regulatory agencies were left with great discretion to decide what would be interpreted as "a substantial portion" of an institution's loans. The most encouraging language was related to the lending territory where the local community would essentially be defined by areas around the office, or offices and all other areas "equidistant" from those areas. The regulators provided for the most discretion in the third option, where an institution could define any type of area it pleased as long as it could convince the regulator that this did not unreasonably exclude low- and moderate-income areas. Although there is often a substantial overlap between low- and moderate-income areas and minority areas, they are not the same. Over the evolution of the CRA regulations, this third option has provided the most leeway for allowing institutions to gerrymander their service areas and continue redlining.

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[10] The regulations and the introductory comments are found in the *Federal Register*, Volume 43, Number 198 for Thursday, October 12, 1978, at pages 47114 to 47155.

On the positive side, the regulations set up twelve assessment factors. These included factors related to the process that the institution had used to contact local organizations and assess local credit needs. Two of these factors related directly to fair lending. Factor "D" (also commonly referenced as assessment factor number 4) took account of "any practices intended to discourage applicants for the types of credit set for in the institution's CRA statement(s)". Assessment factor number "F" (also commonly referenced as assessment factor number 7) took account of "evidence of prohibited discriminatory or other illegal credit practices".

In the introductory section for the regulations (titled "Supplementary Information"), the regulatory agencies comment on assessment factor "F" by noting that it "refers chiefly to violations of the Equal Credit Opportunity Act and the Fair Housing Act." The commentary goes on to state that "some commentators felt that 'violations' could be determined only by a court. However, the Agencies believe evidence of violations found by examiners would be a material consideration in evaluating applications covered by the CRA."

The substance and comments on the interpretation of factor F was, perhaps, the most encouraging part of the regulations in terms of tying the CRA to the prohibition of discrimination and redlining. Clearly, the courts had already determined that the Fair Housing Act prohibited redlining and the agencies were stating that the Fair Housing Act was one of the two main laws to be used in assessment factor F. Second, these comments made it clear that the threshold for evidence of a violation was not only a finding in court, but findings by the examiners as well. Here, the regulations did seem to follow the concept that a lender that violated the fair lending laws would fail the CRA exam.

The Guidelines for Disclosure of Written Evaluations 1990

Further light was shed on the inclusion of fair lending in the CRA process when the agencies released the Uniform Interagency Community Reinvestment Act Guidelines for Disclosure of Written Evaluations.[11] Here, the Agencies showed how the twelve individual assessment factors were actually grouped into five major "performance categories". The first category covered two assessment factors under the heading of "Ascertainment of Community Credit Needs." The second category grouped three assessment factors under the heading of "Marketing and Types of Credit Offered and Extended." The third category grouped two assessment factors under the heading of "Geographic Distribution and Record of Opening and Closing Offices". The fourth category grouped assessment factors D and F under the heading of "Discrimination and Other Illegal Practices." The final category grouped three assessment factors under the heading of "Community Development."

[11] These guidelines were released by the Federal Financial Institutions Examination Council on April 25, 1990, as part of an amendment to the CRA that required the release of a public version of the CRA rating and exam for each institution.

The guidelines then provided profiles of how each of these five groupings of assessment factors is related to the ratings given to the institution. Under Category IV (Discrimination and Other Illegal Practices) the guidelines read in part, "The institution is evaluated in this category on its compliance with antidiscrimination and other related credit laws, *including efforts to avoid doing business in particular areas* or illegal screening" (emphasis added).

The CRA is not a "credit law". Income is not a protected class and the antidiscrimination laws do not prohibit treating low- and moderate-income areas differently from other areas unless that has a disproportionate effect on a protected class.[12] While the CRA states that lenders have an affirmative obligation not to avoid serving low- and moderate-income areas, not avoiding low- and moderate-income areas is hardly proof of compliance with the fair lending laws. Therefore, the statements concerning "efforts to avoid doing business in particular areas or illegal screening" must include the Fair Housing Act and ECOA.

In relating this category of assessment factors to the CRA ratings, the guidelines indicate that in order to receive a passing CRA rating of Satisfactory or Outstanding, the institution needs to be in substantial compliance with all antidiscrimination laws and regulations. A failing grade of Needs to Improve is given to any institution where "substantive violations are noted on an isolated basis" and a rating of Substantial Noncompliance is given to an institution that "has demonstrated a pattern or practice of prohibited discrimination, or has committed a large number of substantive violations of the antidiscrimination laws and regulations".

Under these guidelines, a lender with even an isolated substantive violation of the fair lending laws should clearly receive a failing rating on these factors. Thus, it is the standards for these fair lending laws and not any other standard in the CRA, that must be used to determine if the institution has violated any "discrimination and other illegal practices". That is, the CRA does not amend the fair lending laws or require that they be applied in some special way to institutions covered by the CRA.

The Restructuring of the Regulations in 1995 - The Historical Context

In December of 1993, the Federal agencies responded to a request by President Clinton to revise the CRA regulations to make them more objective and effective. This was done during a period of increased awareness of racial redlining and discrimination by regulated lenders. In May of 1988, the *Atlanta Journal/Constitution* ran a Pulitzer Prize winning series on racial redlining and discrimination by the banks and savings institutions in Atlanta ("The Color of Money" by Bill Dedman). This refocused national attention on lending discrimination and helped lead to changes in the HMDA that produced individual loan data by race and ethnicity. By 1993, these data were routinely used by the regulatory agencies and the public in reviewing racial lending patterns.

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[12] ECOA does prohibit discrimination against an individual based on the source of one's income coming from a form of public welfare, but no law protects persons or areas based on their income, *per se*.

Also, the Department of Justice began a series of lending discrimination cases against depository lenders, beginning with Decatur Federal, the main lender criticized in the Color of Money series. DOJ settled its case against Decatur Federal in 1992. The complaint cited the exclusion of most of the African-American communities in Fulton County (which includes Atlanta) as a violation of both the Fair Housing Act and the Community Reinvestment Act. The consent decree required the lender to expand its CRA area to include all of the minority areas it had previously excluded in Fulton County. This began a series of DOJ cases against depository institutions where the exclusion of minority areas from the lender's CRA community was cited as a violation of the fair lending laws.

In June of 1993, DOJ began its investigation of Chevy Chase in the Washington, D.C., metropolitan area. The resulting complaint also included charges of racial redlining in the delineation of the Chevy Chase CRA community. The settlement (in August of 1994 prior to the publication of the final CRA regulations) required the lender to include all of the District of Columbia in its CRA service area.

Therefore, during the period of the reform of the CRA regulations, racial redlining was clearly defined as a violation of the fair lending laws and the CRA by the Department of Justice. The DOJ settlements included a section on CRA compliance focused on expanding the service areas to include minority communities.

Restructuring of the Regulations and the Assessment of Discrimination

In December of 1993, the regulatory agencies proposed major changes to the CRA regulations, allegedly to streamline the process and provide for a wide range of investment and development activities. As noted in the December 7, 1993, memo to the Federal Reserve Board from its staff seeking approval to publish the proposed regulations, the new regulations were the response from President Clinton to "develop more objective, performance-based assessment standards that minimize compliance burden while improving performance."

As part of the background for the regulations, the Fed had sought advice from its own Consumer Advisory Council. In the list of its recommendations for CRA reform the first item was that "evidence of willful discrimination should result in an automatic "substantial noncompliance" CRA rating."[13] This seems no more than a restating of the ways in which the existing two fair lending assessment factors were to be applied.

In the introductory section of the proposed regulations (titled "Supplementary Information"), the Agencies stated flatly that a "financial institution is not serving its

[13] This list was attached to the December 3, 1993 memo from the staff to the Federal Reserve Board, but this item was not mentioned in the entire 32 page summary of the proposed regulations by the staff that had developed the regulations.

entire community adequately if it is discriminating illegally."[14] The comments went on to summarize the language in the proposed regulations relating to evidence of illegal discrimination. "Therefore, there would be a rebuttable presumption that an institution would receive a composite rating of less than satisfactory if the institution committed an isolated act of illegal discrimination of which it has knowledge that it has not corrected fully or is not in the process of correcting fully or engaged in a pattern or practice of illegal discrimination that it has not corrected fully."

In the proposed regulations, however, these considerations of illegal discrimination were no longer direct assessment factors. Newly proposed revisions of the CRA regulations eliminated the original twelve assessment factors and replaced them with three "tests". There would be a lending test, an investment test, and a service test. The lending test did not include an analysis of racial disparities. The two factors related to discrimination had been eliminated and replaced by the statement reviewed above.

While it appeared that a lender with an isolated but substantive violation of the fair lending laws would automatically fail the CRA exam, many community groups criticized the provision throughout the regulations that continually provided the institution with a private internal opportunity to rebut a rating or finding while providing no such opportunity for the community and general public. Since the exam procedures regularly provide for interaction with the lender, the lender surely has an opportunity to respond to the examiner's concerns prior to the examiner making a finding. This "rebuttable presumption" simply gave the lender a special second, and secret, chance to influence the examination process.

In a revised set of proposed regulations in October of 1994, the agencies claimed that they were responding to this concern by removing the institution's right of rebuttal, but at the same time, they also removed the provision that required a failing CRA rating when evidence of illegal discrimination was found.[15] The final regulation published on May, 4, 1995, only indicates that "evidence of discrimination or other illegal credit practices adversely affects the [regulatory agency's] evaluation of the [institution's] performance." This is followed by a statement that the agency will consider the "nature and extent of the evidence" and any corrective actions that the institution has taken (for example §25.28(c) in the version for the OCC).[16]

In the final regulations, the three assessment tests all have pages of prescribed guidelines as to how they are to be determined. They even have a numerical scoring system assigned to them and to the overall "composite" rating from the three assessment factors (at page 22170 in the *Federal Register*). The consideration of illegal discriminatory practices is tacked onto the composite rating after it has already been

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[14] See *Federal Register*, Volume 58, Number 243, Tuesday, December 21, 1993, pages 67466 to 67508.

[15] The proposed regulations appear in the *Federal Register*, Volume 59, Number 194 for Friday, October 7, 1994, pages 51232 to 51324.

[16] See the final regulations published in the Federal Register, Volume 60, Number 86 for Thursday, May 4, 1995, pages 22156 to 22223.

calculated. There is only a single vague sentence relating to how an examiner will take discrimination into account. There is no scoring system of any kind for taking account of discrimination. In an objective - and numerical - rating system, it has no assigned values. One might reasonably suggest that in this context, it counts for nothing.

Ironically, while the fair lending examination procedures of the regulatory agencies essentially alert the examiner to purely subjective underwriting practices as a place where unequal treatment is likely to exist, the determination of evidence of violations of the antidiscrimination laws in the CRA exam is left purely to the subjective opinions of the examiner. Moreover, this subjective process for treating the evaluation of discriminatory practices does not conform to the request from President Clinton to develop more objective and performance-based standards.

Critical Changes in the Delineation and Treatment of the Service Area

Next, the local community service areas were eliminated in the CRA regulations and were replaced by the delineation of an "assessment area". These "assessment areas" are the geographic areas used in the CRA examinations. Therefore, unless these areas are challenged by the regulatory agency, the assessment tests are applied only to how well the institution serves these particular geographic areas. I believe it is important to quote the exact language contained in the interpretive introduction to the final regulations, as it reflects the thinking of the regulatory agencies in regard to this issue. With respect to the changes in the designation of the "delineated community", selected sections of the introductory interpretive section read:

> *…the agencies have decided to place a different emphasis on the institution's specific delineation and the methods used by the institution to establish that delineation.*
>
> *The agencies do not expect that, simply because a census tract or block numbering area is within an institution's assessment area, the institution must lend to that census tract or block numbering area*. (emphasis added) The capacity and constraints of the institution, its business decisions about how it can best help to meet the needs of its assessment area, including those of low- and moderate-income neighborhoods, and other aspects of the performance context, would be relevant to explain why the institution is not serving portions of the assessment area(s).
>
> The rule also clarifies that an institution's delineation of its assessment area(s) is not separately evaluated as an aspect of CRA performance, although the delineation will be reviewed for compliance with the assessment area requirements of the rule. If, for example, an institution delineated the entire county in which it is located as its assessment area but could have delineated its assessment area as only a portion of the county, it will not be penalized for lending only in that portion of the county, so long as that portion does not reflect illegal discrimination or arbitrarily exclude low- or moderate-income geographies.

To simplify the process of delineating an assessment area, the final rule encourages institutions to establish assessment area boundaries that coincide with the boundaries of one or more MSAs or one or more contiguous political subdivisions, such as counties, cities, or towns. *An institution is permitted, but is not required, to adjust the boundaries of its assessment area(s) so as to include only the portion of a political subdivision it reasonably can be expected to serve.* (emphasis added) This provision gives institutions some flexibility in their delineations, particularly in the case of an area that would otherwise be extremely large, of unusual configuration, or divided by significant geographic barriers. As with the 1994 proposal, however, such adjustments may not arbitrarily exclude low- and moderate-income geographies from the institution's assessment area(s).

Equidistant Principle. The 1994 proposal would have adopted the effective lending territory principle from the current regulations in slightly modified form. The 1994 proposal would have explicitly linked an institution's CRA obligations to the areas around its branches and deposit-taking ATMs, rather than its other non-deposit taking offices.
The service area delineated by the institution would have had to include all geographies around its branches in which the institution originated or had outstanding during the previous year a significant number and amount of home mortgage, small business and small farm, and consumer loans and any other geographies equidistant from its branches and deposit-taking ATMs.
The final rule eliminates the equidistance principle as a required part of the delineation of an assessment area. This change provides institutions greater flexibility in their delineations. (*Federal Register*, Vol. 60, No. 86, page 22171, emphasis added).

While the regulations maintained the general requirement that the assessment area must consist of "whole geographies" and "may not reflect illegal discrimination", these general provisions were subject to the specific regulations about how the area may be drawn.[17] First, one needs to understand that "geographies" are defined in the regulations as "census tracts", not counties or metropolitan areas, etc. Second, the regulation states that the area must "include geographies in which the bank has its main office, its branches, and its deposit-taking ATMs, as well as *the surrounding geographies in which the bank has originated or purchased a substantial portion of its loans*" (emphasis added). Third, whatever the method of defining the assessment area the regulations provide that "a bank may adjust the boundaries of its assessment area(s) to include only the portion of a political subdivision that it reasonably can be expected to serve". Finally, one must recall that in defining the area, these regulations eliminated the "equidistant" requirement which was seen by the community groups as the one standard that could

[17] While the language for each agency is essentially the same, the quotations here are taken from the regulations in §25.41 for the Comptroller of the Currency.

actually limit the ability of the institution to skip over or surround minority areas without including them in the service area.[18]

The Scoring System and the Lending Test

In the revised regulations, CRA ratings are produced by a scoring system assigned to the various tests. Ratings are based on performance within the lender's assessment area(s). In addition to its own activities, a lender may elect to include the lending of all of the affiliates of its holding company. Based on a review of the examination procedures and many public CRA evaluations, when the lending of affiliates is included in the examination, all of the lending is aggregated together and no separate analysis is done of the patterns for different affiliates. Only the loans of the affiliates inside the assessment area are included in the analysis. The analysis gives credit for high levels of penetration in the assessment area without regard for the type or risk level of the loans. Based on this system, a lender that receives an Outstanding on the lending test is assigned 12 points. In the overall composite, a lender needs only 11 points to get a Satisfactory rating overall. Therefore, a lender who gets an Outstanding rating in the lending test passes the CRA exam. Moreover, while the regulators give lip service to taking account of challenges to an application by third parties, they make it clear that a CRA examination and its rating "is an important, and often controlling, factor in the consideration of an institution's record".[19]

Given these regulations, a lender who made no loans or only a few loans in minority census tracts, but who made more loans in white census tracts, could draw the boundary of the assessment area as a collection of white census tracts around its facilities – even if there were minority census tracts that were "equidistant" from the facility. The determination of what is "reasonable" and what constitutes illegal discrimination is left to the subjective views of the examiner. Then, if the lender (either by itself or with its affiliates included) provided a high level of loans to this white area, it could be given an Outstanding rating in the lending test, resulting in a passing CRA grade – even if all the loans were high cost, high risk loans. The passing CRA grade would make it extremely difficult for a challenge to block any applications of this lender.

Examples of Regulatory Treatment of Lenders Excluding Minority Market Areas

In sum, the regulatory agencies have revised the CRA regulations to eliminate specific fair lending rating factors, to weaken citizen participation, to help lenders inflate their ratings, and to provide extreme flexibility in defining the CRA assessment area.

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[18] In the "Community Reinvestment Act Interagency Questions and Answers Regarding Community Reinvestments" (*Federal Register*, Volume 66, Number 134, Thursday, July 12, 2001, at page 36641) under a section on the limitations on the delineation of an assessment area there is a single statement that the area cannot "arbitrarily exclude low- or moderate-income geographies". No mention is made relating to excluding minority areas.

[19] See, for example, "Community Reinvestment Act Interagency Questions and Answers Regarding Community Reinvestments (*Federal Register*, Volume 66, Number 134, Thursday, July 12, 2001, at page 36640)

Still, in the language of the regulators themselves, it seems clear that violations of the fair lending laws should automatically result in a failing rating.

The interpretive comments for the original 1978 CRA regulations stated that evidence of discrimination could be found by examiners even without a determination by a court. One would have every reason to believe that racial redlining would certainly be taken into account. The guidelines published in 1990 for disclosure of the CRA evaluations indicated that in reviewing evidence of discrimination, "the institution is evaluated in this category on its compliance with antidiscrimination and other related credit laws, *including efforts to avoid doing business in particular areas"* (emphasis added). These guidelines also indicated that even isolated cases of substantive violations of the fair lending laws would result in a failing CRA rating. Moreover, in the interpretive introduction to the present regulations, the agencies stated flatly that "evidence of willful discrimination should result in an automatic "substantial noncompliance" CRA rating."

The Fair Lending Examination process is defined as the source for seeking evidence of discrimination. Therefore, the CRA regulations recognize the standards of the fair lending laws as the basis for evidence of illegal discrimination to be used in the CRA rating process. The fair lending examination guidelines for all the agencies indicate that racial redlining violates the fair lending laws in either treatment or effect and that examiners should look beyond the CRA assessment area to see if redlining has occurred. Moreover, the fair lending examination guidelines specifically reference the CRA assessment areas in the sections on redlining.

The question, then, is how to explain the cases where the Department of Justice has filed discrimination claims against a lender or a lender has been found to have violated the fair lending laws in court while the regulatory agencies continue to give these institutions the high CRA ratings and continue to grant them branching, merging, and acquisition rights. A review of these cases illustrates the issue. In this context, I provide the following examples of racial redlining allowed by the CRA regulators but found by the Department of Justice (DOJ) to be in violation of the Fair Housing and Equal Credit Opportunity Acts, as well as in violation of the CRA:

<u>The OTS and Mid America Federal</u>

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

In 2002, DOJ filed suit against Mid America for violating the Fair Housing Act and the Equal Credit Opportunity Act.[20] In specifically citing Section 228 of the CRA regulations (Reg BB), the suit stated that, "In establishing its assessment area, also known as its community service area, boundaries under the Community Reinvestment Act of 1977, 12 U.S.C. §§2901-2906 ("CRA"), Mid America has, since at least 1996, excluded nearly all predominantly African American and African American/Hispanic neighborhoods in the Chicago MSA, even those located in close proximity to its branch offices." [See the attached map which reproduces the exhibit from the DOJ complaint.]

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

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

The DOJ suit cites the pattern of expansion of Mid America through the opening of branches in the Chicago metropolitan area. The complaint states that, "Mid America has engaged in a race-based pattern of locating or acquiring new offices. It has located or acquired new branch and other offices to serve the residential lending and credit needs of predominantly white areas but not those of predominantly African American or African American/Hispanic neighborhoods. Mid America has never opened any new full-service branch office in a majority African American or African American/ Hispanic neighborhood. As of March 1, 2002, of Mid America's 33 branch offices, only one, Broadview, is located in a census tract in which a majority of the residents are African American. However, the Broadview branch is the only non-traditional office operated by Mid America. In contrast to all its other branch offices, the Bank's Broadview office consists solely of an ATM machine and a lobby area located inside a K Mart. Moreover, the level of services offered at the Broadview branch is substantially less than that offered at Mid America's other branches. Every other branch office offers mortgage lending or investment services, or both; neither is offered at the Broadview branch."

Opening branches is a privilege that should be granted only to institutions that have satisfied their CRA obligations. By continually allowing Mid America to expand, the OTS was rewarding a major lender in the nation's largest African-American mortgage

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

market for engaging in racial redlining – the very practice that led to the creation of the CRA in the first place.

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

The Federal Reserve Board and Old Kent Bank

Between 1997 and 2001, the Federal Reserve Board had given three Satisfactory CRA ratings to Old Kent Bank, a major lender in the Detroit metropolitan area.[21] During this period, Old Kent defined its assessment area in terms of several counties and parts of counties that encircled the City of Detroit, but excluded the City of Detroit itself. A review of the Public CRA Evaluation reports indicates that the Federal Reserve Board was clearly aware of this exclusion and that it accepted this exclusion of Detroit and evaluated Old Kent based on the service it provided to the predominantly white suburban areas only.

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

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

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

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

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

<u>The FDIC and Centier Bank</u>

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

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

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

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

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

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

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

Meanwhile, First American Bank operated under a Cease and Desist Order from the Federal Reserve based on the prior evidence of discrimination. In November of 2003, First American Bank changed its regulator to the FDIC. In March of 2004, the FDIC gave First American Bank a Satisfactory rating, thus reinstating its privileges to engage in branching and other activities while the DOJ investigation was still ongoing. In July of 2004, four months *after* the passing CRA rating, DOJ settled the case with First American Bank with a series of remedial actions that were to be taken in the future to correct past discriminatory behavior. The FDIC public CRA evaluation mentioned the Cease and Desist Order with the Federal Reserve, but did not mention the DOJ investigation.

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

Flagstar – Violating Your Way to an Outstanding Rating

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

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

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

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

- The OTS conducted five CRA examinations and never found Flagstar in violation of discrimination laws. During this time period, Flagstar was given a "Satisfactory" CRA rating four times and was elevated to an "Outstanding" rating after the summary judgment finding in 2003.

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

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

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

The Optional Inclusion of Affiliates

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

Because Citigroup is the largest bank holding company with some extremely varied and complex affiliate structures, some of the problems with the treatment of affiliates by the regulators can be demonstrated in some examples from different depository institutions that are part of Citigroup. These examples highlight some key issues related to the treatment of affiliates as well as issues related to the CRA comment and challenge process, and issues related to the treatment of claims of discrimination and violations of other credit laws. *These historical examples are used to illustrate functional issues related to the practices of the regulators and not to make a case for or against the lending patterns of the mortgage lending subsidiaries and affiliates of Citigroup in this statement.*

The first example is taken from the Comptroller's Public Evaluation of Citibank, NA in 2003. In the case of the evaluation of Citibank, NA, the institution chose to include all of the affiliate lenders of Citigroup in the CRA examination. The Comptroller lists seven affiliates where the HMDA data were combined with that of Citibank for the lending test. In this case, the Comptroller assigned an Outstanding rating for Citibank's lending test, guaranteeing it a passing CRA rating overall. While I am not questioning the rating in this review, I am concerned with the case as an example of the process used by the Comptroller and which, presumably, would be applied to other institutions as well.

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

One affiliate, Citicorp Mortgage, was one of the largest lenders in the nation, yet only its role as part of the aggregate pattern of all the affiliate lenders in the assessment area was reviewed. Moreover, "93.7% of the HMDA loans in the local assessment area were provided by the bank and the affiliate, Citicorp Mortgage" (at page 7). One issue, then, is that the dominant pattern for the lending test may be determined by a single affiliate. While not suggesting that Citibank's performance would necessarily be different if the affiliates were not used, one can see as a practical matter the any institution's choice to include or exclude affiliates might radically change the lending pattern in a particular assessment area.

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

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

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

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

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

> We found no evidence of illegal discrimination or other credit practices. However, given the previous adverse publicity involving the bank's affiliates,

> including Citigroup's settlement with the FTC, the following comments are presented.
>
> With the acquisition of Associates First Capital Corporation in September 2000 and subsequent consolidation with Citifinancial, Citigroup has committed to resolve concerns that had been raised against the former Associates involving alleged deceptive and abusive lending practices.
>
> In considering any potential impact to our CRA assessment of Citibank, we acknowledge Citigroup's efforts to address individual customer concerns and the minimal impact that lending by the affiliate had to the overall lending in the bank's AAs. Therefore, although the concerns were considered, they did not significantly impact our CRA assessment of Citibank. (at page 11)[22]

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

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

Second, the Comptroller specifically notes patterns for home purchase and home improvement loans while the major claims of potential racial bias in subprime lending at this time were focused on refinance loans, about which the Comptroller's report is silent.

Third, by looking only at the role of the CitiFinancial lenders in Citibank's local assessment areas, the larger role of these subprime affiliates in other markets is ignored. Hypothetically, if there was discrimination in the lending of any of these affiliates in some other area, that would be ignored and a lender would be allowed to use the lending of these affiliates in its assessment area alone to boost its CRA rating.

For example, in 2002, the National Training and Information Center (NTIC) studied the distribution of prime and subprime loans between Citigroup's affiliates in 13

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[22] One may wonder about the scope of the evidence available to the Comptroller as a foundation for acknowledging "Citigroup's efforts to address individual customer concerns". Surely, some fundamental changes were made to the practices of The Associates when it was folded into CitiFinancial. One may note, however, that at the same time that the Comptroller was examining Citibank, the Federal Reserve was investigating CitiFinancial for continued misrepresentations in marketing credit insurance, for violations of HOEPA, and for misrepresentations to the Federal Reserve investigators. In May of 2004, this investigation resulted in a Cease and Desist Order that included $70 million in civil money penalties.

markets around the country from the 2000 HMDA data.[23] This study provides an example of how the role of subprime affiliates can vary from one market to another. In the New York City area, the market was for Brooklyn and Queens, where NTIC found that 11% of the loans were made by subprime affiliates. This was by far the lowest percentage of all the markets they studied. In Baltimore, 85% of the loans were made by the subprime affiliates. In Cleveland it was 93%. In Cincinnati, it was 94%. In Pittsburgh, it was 95%. In Syracuse it was 90%. Outside of the larger urban areas, the percentage of subprime loans was 94% in Des Moines, 96% in Wichita, and 96% in Central Illinois. This shows how one may get a very limited and unrepresentative view of the overall role of an institution's subprime affiliates when looking only at a single institution's assessment area in a CRA examination.

A fourth issue is whether the Comptroller's analysis actually does include all of the subprime affiliates. One affiliate which is missing from those listed by the Comptroller is Citicorp Trust Bank, FSB (CTB). According to the CRA evaluation of CTB by the Office of Thrift Supervision (OTS) in May of 2004, this is a subsidiary of CitiFinancial Credit Company.[24]

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

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

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

As a conceptual issue, debt consolidation refinance loans sold with the solicitation of other credit and insurance products and solicited for continual refinancing (flipping) are the types of loans that have been subject to the most concerns for discrimination and abuse. We are not suggesting here that these statements indicate that CTB engaged in such abusive tactics, but simply that it is important for regulators to pay special attention to these loans.

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

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

If CTB had a depository institution in the New York City area with an assessment area overlapping with that of Citibank, NA, then one could understand that under the policy of not counting loans twice, these loans would be excluded from the affiliates included in the Citibank evaluation. The only assessment area defined for CTB, however, is for the Wilmington, Delaware, MSA. In this case, because CTB originates loans from many areas across the country, the OTS – *at its own discretion* – selected 9 other metropolitan markets outside of CTB's assessment area for review as what it termed "Supplemental Evaluation Areas" to see if the lending patterns in these comparison areas reflected that same high level of service to low- and moderate-income areas as did the small share of CTB's loans in its actual assessment area.[25]

Therefore, by fiat, the OTS appears to have removed these large pools of subprime loans from the CRA evaluations of Citigroup depository lenders in any of the nine supplementary markets that it chose for comparison. Such a move is inconsistent with the CRA regulations and allows a regulatory agency to essentially hide the loans of an affiliate when they should be counted. In the New York City MSA, for example, the HMDA data for CTB indicates that it had 1,251 loans in 2002 and 1,162 loans in 2003.[26] Since CTB is part of CitiFinancial and a subprime lender, these loans should have been included in the Comptroller's evaluation of Citibank, NA.

This action by the OTS in regard to the loans of CTB is not restricted to the case of Citibank, NA. Citibank, FSB, one of the largest federal savings banks in the nation also received a public CRA evaluation in 2003 that reflected the exclusion of the CTB loans. In this case, the OTS defined 8 assessment areas for Citibank, FSB, across the country.[27] These included the Chicago MSA, the Baltimore MSA, two Florida MSAs, the San Antonio MSA in Texas, MSAs in Connecticut and New Jersey, and the Washington, D.C. MSA. The lending test covered loans for all of 2002 and through June of 2003. Citibank, FSB also chose to have the Citigroup affiliates included in its evaluation.

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

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

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

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

Based on the HMDA data for 2002, CTB made 4,274 loans in the eight assessment areas for Citibank, FSB. Meanwhile, the OTS evaluation reported only 5,041 loans from subprime affiliates in the assessment areas for 2003. Including Citicorp Trust Bank loans would have increased the number of these subprime affiliate loans by 85%. In 2003, CTB made 5,181 loans in the eight assessment areas. Counting just half the year would be 2,590 loans. Meanwhile, the OTS evaluation reported just 408 loans from all affiliates for the first half of 2003. Including the estimated half year of CTB loans would have increased the number of these CitiFinancial related subprime loans by 635%. Put another way, the OTS report which considered the subprime lending of CitiFinancial affiliates to be negligible in 2003 included just 14% of the actual number of these loans.[28]

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

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

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

Therefore, from these examples, it is not clear that the regulators include all of the affiliates that should be included when an institution chooses this option. Moreover, a

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

holding company can review the lending patterns of its affiliates and the areas covered by the assessment areas of its depository institutions and structure the choices concerning the inclusion of affiliates in ways that provide the most favorable lending picture for each institution subject to the CRA.

Linking the CRA to the Fair Lending Examination Process

In the revised CRA regulations the assessment of discrimination is left to the lone directive to take account of evidence of discriminatory behavior and consider whether changes should be made to the overall CRA rating already assigned to the lender in the systematic process for the various tests. In the examination procedures for the CRA, the regulators are instructed to use the most recent fair lending compliance exam as the basic source for locating evidence of discrimination. Therefore, these fair lending examination procedures need to be reviewed to understand how evidence of discrimination should be determined when completing the CRA exams.

In 1994, the FFIEC issued the Interagency Fair Lending Examination Procedures. The various fair lending examination procedures and guidelines for the individual regulatory agencies reflect the FFIEC guidelines with generally only minor variations. We shall use examples from the specific guidelines for the Comptroller of the Currency, the Federal Reserve, or the Office of Thrift Supervision.[29]

First, in order to use the results of the most recent fair lending exam, there must be a recent exam. In the OCC process, some lenders are not identified for a regular exam and are only selected through a random process. This means that it may be many years before some lenders receive an exam.

Even if the lenders are chosen, the examinations are designed to be directed toward one or a few selected "focal points" rather than a full review.[30] Focal points relate to different types of discrimination issues such as redlining, marketing, steering, etc. In some cases these focal points can be determined by statistical analysis, though this requires that the lender have enough files of different loan types by different racial and ethnic groups to fit the requirements of the statistical models. Then, even within the selected focal points, the exam may be limited in scope and breadth. The Comptroller's procedures, for example indicate that only a limited exam may be done if there are "no unresolved fair lending complaints, administrative proceedings, litigation or similar factors" (at page 22).

[29] These are the *Federal Reserve Consumer Compliance Handbook*, "Federal Fair Lending Regulations and Statutes – Examination Procedures" (updated to January 2006), and *Comptroller's Handbook – Consumer Compliance Examination*, "Fair Lending Examination Procedures" (updated to April 2006), and Office of Thrift Supervision, *Examination Handbook*, Section 1200 (updated to March 2007).

[30] See, for example, pages 12 and 69 in the Comptroller's examination procedures.

This seems to suggest that if consumers do not actually file complaints, the regulatory agencies may do only a limited fair lending examination. Of course, lending is an area where consumers are often unaware of whether they have been treated differently from other applicants, so uncovering discrimination depends upon the regulatory agencies using their investigative powers to search for such differential treatment.

Where a lender operates in several metropolitan markets, the regulators are instructed to limit the exam to only what "can be reviewed readily in depth, rather than selecting proportionally to cover every market"[31] Thus, all the market areas for large lenders are not covered in the exam.

There are several sections of the exam procedures, such as the sections on loan product steering and marketing where the examination procedures refer to patterns that may segment the market between the lender and affiliates. For example, the Comptroller's procedures state that, "Institutions that make FHA and conventional loans and those that lend in both prime 'A' markets and in subprime markets (either directly or through affiliates), present opportunities for loan officers to refer or 'steer' applicants from one product or market to another" (at pages 45-46).[32] Nonetheless, the fair lending examinations specifically instruct the examiners to "limit the inquiry to what can be learned in the institution and do not contact the affiliate" (at page 15).[33]

This creates two issues. One issue is that affiliates are simply not examined. As the mortgage lending markets have changed dramatically over the past three decades since the CRA was passed, holding company affiliates often are the primary mortgage lenders. Moreover, some holding companies channel different loan products (FHA, subprime, jumbo, GSE conforming) through different affiliate companies. Therefore, the lack of any review of affiliates leaves a massive hole in the fair lending examination process. Second, at the election of the lender, CRA exams may include all of the affiliates of a lender's holding company. This creates a serious mismatch between the lending patterns subject to review in the fair lending exam and the aggregate patterns used in the CRA exam.

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[31] See, for example, page 3 in the Federal Reserve's examination procedures.

[32] A specific problem in the examination procedures relating to steering of FHA loans are the uniform comments that in reviewing steering between conventional and FHA products, the examiner should focus on loans greater than $100,000. Given the focus of FHA lending on lower valued homes, this seems odd. Perhaps in markets like California, DC, New York City or Boston, the high home values blind people to the reality that there are still vast markets where loans are under $100,000. This examination directive would eliminate many minority markets where loan values are disproportionately below $100,000 and where steering to FHA loans has historically been a major issue.

[33] In the interpretive introduction to the 1995 CRA regulations, the agencies also indicate how affiliates are not to be examined, stating that, "although lending by affiliates may be treated as lending by an institution, this treatment for CRA purposes will not permit a regulatory agency to examine any institution or its affiliate if it does not otherwise have such authority."

In the CRA exam, lending is only reviewed within the CRA assessment area, while no such restrictions are defined in the fair lending examinations. Therefore, the results of the fair lending exams are likely to reflect patterns that do not conform to the areas for the CRA exam. In addition to these inconsistencies and mismatches, the fair lending examinations provide very little guidance in how examiners are to compare the underwriting or marketing practices of a lender to the legal standards of the fair lending laws.

In quite uniform ways, the fair lending examination procedures for the regulatory agencies specifically cover redlining – and with specific references to the CRA. Taking references from the Federal Reserve procedures, examiners are told to look at recent CRA evaluations and "identify and delineate any minority areas within the lender's CRA assessment area or market area for residential loan products that are of a racial or national origin minority character." Examiners are then instructed to determine whether any such area "appears to be excluded, underserved, selectively excluded from marketing efforts, or otherwise treated less favorably in any way by the lender" (at page 16). On the same page, the procedures contain a special note indicating that while "the CRA assessment area can be a convenient unit for redlining analysis", examiners should look to all areas where the lender "could reasonably be expected to have marketed and provided credit" and that "some of those might be beyond or otherwise different from the CRA assessment area". This is reflective of introductory comments at the beginning of the examination procedures that reminded the examiner that, "In thinking about an institution's credit market, examiners should recognize that these markets may or may not coincide with the institution's CRA assessment area(s)" (at page 2).

As part of the redlining analysis, examiners are directed to review the lender's marketing procedures. The procedures states that, "A clear exclusion of the suspected redlined area from the lender's marketing of residential loan products supports the view that the lender did not want to do business in the area. *Marketing decisions are affirmative acts to include or exclude areas*" (at page 19, emphasis added). No marketing practice could be more clear and intentional that the delineation of the assessment area that the lender defines as its local community where it will be evaluated for CRA purposes.

Finally, the examination procedures indicate that redlining violates both the Fair Housing Act and ECOA whether the redlining results from purposeful actions or the effect of policies and practices.[34] Even if the exclusion of minority areas were unintended, it would have a discriminatory effect. The only defense against such effects is that there is a business necessity. In the exam procedures for the Federal Reserve this is defined as a "compelling business justification" (at page 21). The examination procedures for the Comptroller state that the "Justification must be manifest and may not be hypothetical or speculative" (at pages 8-9).

[34] See, for example, page 53 of the Comptroller's procedures or page 15 of the Federal Reserve's procedures.

Ignoring the Negative Impacts of Lending and Loan Servicing

The regulatory agencies charged with enforcement of the CRA have been issuing guidance and warnings about predatory lending since the late 1990s. In 2000, HUD and Treasury jointly issued a report on the abuses of predatory lending, the growth of the subprime market where predatory practices are most common, and on the dire impact of subprime foreclosures on communities – largely minority communities.[35] Yet, as is shown in the examples above, the regulators gave high ratings to lenders that had concentrated subprime lending in low- and moderate-income communities.

In April of this year, Comptroller Dugan testified before the Financial Crisis Inquiry Commission that in the peak years of subprime lending (2005-2007) national banks "originated" just 10.6% of the subprime loans.[36] In Appendix B to his statement, however, Comptroller Dugan himself presents other studies that indicate that his figures are based on a very limited view that only includes loans with selected features that were originated directly by a national bank itself. It ignores the loans made by other affiliates of that same bank's holding company. Using the definition of "high cost" loans from the Home Mortgage Disclosure Act, the Comptroller cites other figures that include all affiliates that indicate that 54% of the subprime loans in 2006 and 79.6% of the subprime loans originated in 2007 were originated by institutions subject to federal regulators.[37]

However one counts these loans, what has been generally ignored until the work of the Financial Crisis Inquiry Commission is that some lines of credit used by the independent mortgage companies (such as warehouse loans used to originate loans and store them prior to sale or securitization) come from commercial lines of credit such as those from the largest national banks. Again, in his statement before this Commission last April, Comptroller Dugan (even using his own carefully parsed definitions) indicated that national banks provided at least $33 billion in warehouse lines of credit to subprime lenders.[38]

Therefore, while the national banks may not have made the majority of subprime loans directly, they provided the funds to the lenders that did originate the loans. In addition, the national banks participated in the securitization of the pools of loans made from the bank lines of credit. In this way, the national banks provided support for the entire subprime industry at both the front and back end of the process. Without this

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[35] U.S. Department of Housing and Urban Development and U.S. Department of the Treasury, *Curbing Predatory Home Mortgage Lending: A Joint Report*, (June 20, 2000).

[36] Comptroller John C. Dugan, written statement submitted to the Financial Crisis Inquiry Commission, April 8, 2010, at page 8. [http://fcic.gov/hearings/04-08-2010.php]

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

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

support, the industry could not have gown to the scale where it caused the meltdown of the financial markets.

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

Nonetheless, as indicated in a recent report by the Center for Responsible Lending, some of the largest mainstream banks are making high interest loans (based on the fees for the loans) against the future paychecks of the account holders.[39] In addition to these direct "payday" loans, the NPA "Payday Lender Financing Factsheet" I am submitting with my testimony shows how the large national banks are funding the payday lenders with lines of credit and other financial resources. For example, the factsheet indicates that Wells Fargo is involved in funding approximately 30% of the payday industry (based on the payday store locations).

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

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

Finally, we have seen in both litigation against servicers and in the operation of the Making Home Affordable Program (HAMP) how abusive and mismanaged servicing operations have contributed to the massive levels of foreclosure and abandonment all across the country in all types of communities. Yet, the CRA has failed to examine servicing issues once loans have been made or purchased.

The Elimination of the Assessment of Credit Needs

Aside from placing "a different emphasis" on how a lender could delineate its CRA assessment area, removing a review of how the assessment area is defined as a specific factor in the CRA examination, and eliminating the direct assessment factors related to lending discrimination, the final regulations also eliminated other factors that were important to the assessment of an institution's fair lending.

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

For example, the rating factors that specifically addressed how the lender assessed the credit needs of its community service area were also eliminated. In the interpretive comments published with the May 4, 1995 regulations the agencies state that, "Under the final rule, the agencies will neither prepare a formal assessment of community credit needs nor evaluate an institution on its efforts to ascertain community credit needs."

In the past, when citizens and organizations have placed comments in the lender's CRA file, these were reviewed as part of the factors related to the lender's assessment of credit needs. These comments, challenges, and other activities provided community organizations and the general public with a vehicle to define credit needs, propose the types of programs or loan products that could serve these needs, and also to identify possible redlining and discrimination issues in the delineation of the service area or in the operations of lending programs. Eliminating the assessment factors related to assessing community credit needs cut the public out of the CRA examination and rating process and reduced the CRA to a private relationship between the lender and the regulatory agency.

Where Are We Now?

Thus, the present CRA regulations have not kept pace with the changing financial markets and they have not served the purposes for which the CRA was originally designed. Some of the most serious deficiencies in the regulations and the examination process are:

(1) removing the obligation of depository institutions to define a local service in a way that eliminates racial redlining;
(2) removing the separate assessment of discriminatory actions from the formal rating process and;
(3) failing to develop and implement a sound fair lending examination process that includes both the subsidiaries and affiliates of a covered institution;
(4) relegating compliance with the fair lending laws to an undefined appendage of the rating process subject to the pure discretion of the regulatory agencies such that institutions can receive Outstanding CRA ratings while they violate the fair lending laws;
(5) removing the review of the institution's assessment of local credit needs from the evaluation process;
(6) removing the assessment of the institution's efforts to communicate with its community in defining credit needs;
(7) granting an institution a passing CRA rating if they have an Outstanding in the lending test (even if the lending area redlines minority communities);
(8) making challenges futile by granting an institution with a passing CRA rating a presumptive bias in favor of approving applications;
(9) failing to regularly hold hearings when an application is challenged;

(10) basing CRA compliance only on the lending and investment activities within an assessment area (or selected assessment areas) based on bricks and mortar facilities (or selected market areas) rather than the actual lending and investment patterns of the financial institution and its affiliates in all markets where it operates; and

(11) failing to take account of the negative impacts of some forms of lending.

Blaming the Financial Meltdown on the CRA

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

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

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

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

Rejecting the option of financial welfare, the CRA was simply a requirement that for the benefit of taxpayer-backed deposit insurance (and, today, the bailout slush funds) the banking industry owes it to the American people to seek ways of investing and lending creatively, but soundly, in all communities. It was not a demand to loan to

lower-income persons and minorities regardless of their financial situations. It was a call on the financial markets to use the creativity, ingenuity and the resources of the free market system for fair lending and to build a development banking industry in our country as a basis for the reinvestment in communities that had been discriminated against or that lagged behind new growth areas where the money flowed so freely.

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

The reinvestment programs created sound products. Loan programs were specifically developed to account for the needs and situations of low- and moderate-income borrowers who were typically unfamiliar with credit markets. Counseling programs and careful monitoring of programs produced portfolios that often outperformed the larger mainstream credit markets. **In its own study of CRA program loans, the Federal Reserve noted that the median loss rate on these reinvestment programs was exactly zero.**[40] According to a report issued by the Federal Reserve Board of Dallas last year "…data…suggest that the CRA prevented the subprime situation from being more severe."[41]

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

> Overwhelmingly, this lending has been safe and sound. For example, single family CRA-related mortgages offered in conjunction with NeighborWorks organizations have performed on a par with standard conventional mortgages. Foreclosure rates within the NeighborWorks network were just 0.21 percent in the second quarter of this year, compared to 4.26 percent of subprime loans and 0.61 percent for conventional conforming mortgages.[42]

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

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

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

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

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

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

The people who created the CRA in response to the abusive and exploitive FHA lending practices of the 1970s were not stupid. They would not choose toxic loan products over sound products when they had the choice. For their part, the community organizations that had been working on reinvestment for over thirty years, warned Washington of the coming nightmare as abusive lending progressed into massive foreclosures. While the media now praises as great prophets the economists and regulators who saw the meltdown coming as early as 2005, it was the community groups in the 1990s who first suffered the scars of a new wave of foreclosures and saw in it the resurrection of massive lending scandals.

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

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

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

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

fraud in the mortgage markets (largely related to brokers and appraisers) have increased thirty-fold since 1997.[43]

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

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

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

There is no question that the subprime debacle has contributed to a real need to intervene to ward off a crisis in the global financial markets. Everyone recognizes the need to secure the credit markets. But the organizations that represent the communities that have already paid twice for the failure of the government to protect them from fraud

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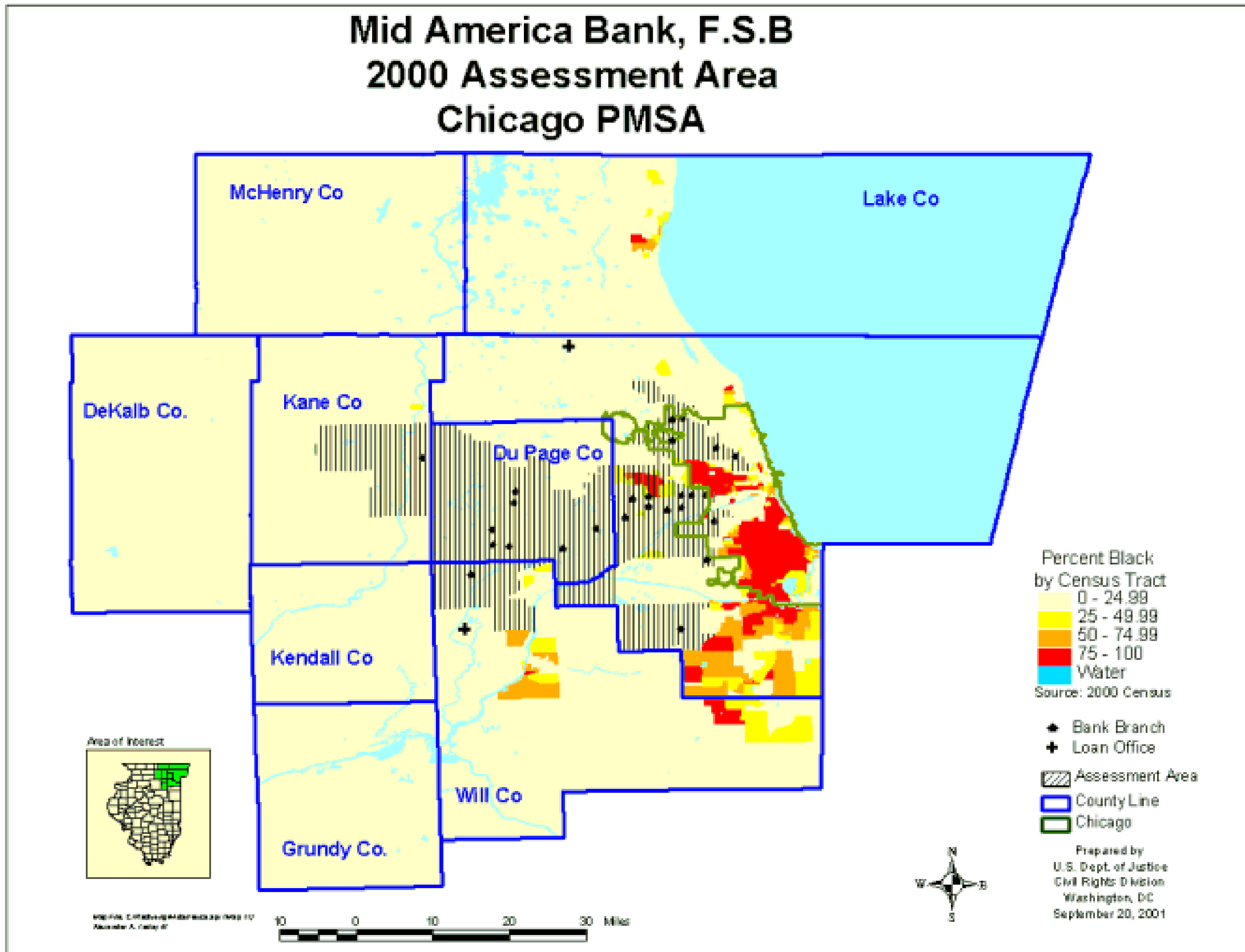
[43] Financial Crimes Enforcement Network, U.S. Department of Treasury, *An Update of Trends Based Upon an Analysis of Suspicious Activity Reports*, April 2008, page 21.

and lending abuses on a massive scale want to know why it is possible to develop interventions costing hundreds of billions of dollars for Bear Sterns, Fannie Mae, Freddie Mac, AIG, and now the entire lending and investment market within a few days while the homeowners who were victimized by the lending abuses were abandoned year after year. Why, they ask, are these financial institutions too big to fail while the collected millions of homeowners in American communities are not.

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

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

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



Old Kent CRA Assessment Area as of March 2000
Detroit MSA, Michigan

Lapeer Co

St Clair Co

Oakland Co

Macomb Co

Wayne Co

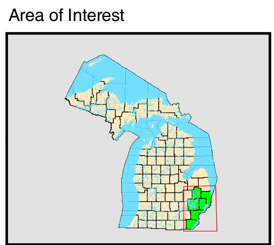
Monroe Co

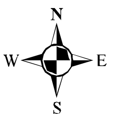
Percent Black by Census Tract

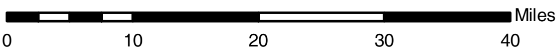
- 0 - 24.99
- 25 - 49.99
- 50 - 74.99
- 75 - 100
- Water

Source: 2000 Census

- Assessment Area
- County Line
- Detroit
- Other Cities







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Civil Rights Division
Washington, D.C.

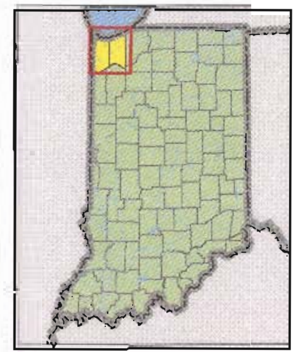
Percent Minority (Non-White NH) Population by Year 1990 Census Tract
December 1998 Assessment Area
Gary MSA, Indiana

Other States
Other Counties
Assessment Area
Places
Water Bodies

Majority Minority %

0.00% - 25.00%
25.01% - 50.00%
50.01% - 75.00%
75.01% - 100.00%
Unpopulated

Demographic's Source:
1990 U.S. Census



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U.S. Department of Justice
Civil Rights Division
Washington, D.C. 20530