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Democratizing Capital: The History, Law And Reform of the Community Reinvestment Act

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INTRODUCTION

The term “democratizing capital” in this book’s title has two related meanings, and the Community Reinvestment Act (“CRA”) democratizes capital in both ways. The first may be analogized to voting. The CRA has democratized decisions about the distribution of capital by extending at least part of the decision-making “franchise” to previously “disenfranchised” people, in particular low-income and minority persons. Second, the CRA has played a role in distributing loans to people—particularly low-income and minority individuals—who previously did not receive loans, thus including them in the economic mainstream and giving them the same economic opportunity as others. The CRA has done this by influencing banks to make loans to low-income and minority individuals to purchase, refinance, or improve a home; to open or expand a small business; or to support a small farm.

The seeds for democratizing capital are contained in the statute that enacted the CRA. The CRA imposes on banks a “continuing and affirmative obligation to help meet the credit needs of the local communities in which they are chartered,” including low- and moderate-income (“LMI”) neighborhoods. The CRA places enforcement of this obligation in the hands of four federal administrative agencies that regulate banks (the “federal banking agencies” or the “agencies”). The CRA requires these agencies to examine each bank periodically to determine whether it is helping to meet community credit needs, to issue a written public report—including a rating—evaluating the bank’s CRA performance, and to take the bank’s CRA record into account when considering certain bank expansion applications. When a bank files one of these expansion applications, any member of the public may file comments with the federal banking agency that regulates the bank opposing the application on the basis that the bank has failed to meet its CRA obligations. Members of the public, and in particular community-based organizations operating in LMI, predominantly minority, and inner-city neighborhoods (collectively “redlined neighborhoods”) have used this opportunity to file comments opposing bank merger applications.
The seeds for democratizing capital have borne fruit. The opportunity for disenfranchised members of redlined neighborhoods to comment on a bank's CRA record when it files an expansion application has given them a powerful voice in decisions about the distribution of loans. Banks, which are generally sensitive to bad publicity and risk-averse in their expansion applications, are anxious to have good CRA records both as good public relations and to ensure approval of their expansion applications. Public comments, and the delay and risk they cause to bank expansion plans, have brought banks to the bargaining table with community groups, resulting in bank pledges to lend more than one trillion dollars to LMI and predominantly minority neighborhoods nationwide. Even if banks do not have expansion plans in the immediate future, their desire for good public relations, their discovery that CRA-related lending can be profitable, and their desire to prevent comments opposing future expansion applications have motivated them to change their lending practices, introduce new loan products, and partner with community groups to make lending to LMI and minority persons and neighborhoods part of their business strategies.

Despite its success in democratizing capital, the CRA has not reached its full potential. There remains a disproportionate distribution of costly subprime lending in LMI and predominantly minority neighborhoods and a disproportionate percentage of low-income persons who do not participate in the banking system.

The thesis of this book has four parts. First, one of the main reasons the CRA has not reached its full potential for democratizing capital is that the federal banking agencies utilize subjective standards for evaluating the CRA performance of banks. Such standards limit the power of the franchise the CRA extends to LMI and minority persons and the amount of capital they receive because subjective standards make it difficult to hold a bank accountable for a poor CRA record or to know how much lending a bank should be doing.

Second, in contrast to subjective standards for evaluating CRA performance, a fixed set of criteria composed of quantitative measures of bank lending, quantitative measures of community credit needs, and objective standards for evaluating bank lending would maximize the CRA's potential for democratizing capital. Such criteria would make it easier to hold a bank accountable for a poor CRA record and would more clearly define how much lending a bank should be doing.

Third, a major reason the agencies have failed to adopt quantitative measures and objective standards for evaluating CRA performance is the agencies' fear that such standards would allocate credit. The CRA's legislative history makes clear that Congress did not intend the CRA to allocate credit, and the agencies fear credit allocation could lead to unsafe and unsound banking practices.

The fourth part of the thesis is that it is possible to establish criteria for evaluating CRA performance that are composed of quantitative measures and objective standards that maximize the CRA's potential for democratizing capital without allocating credit. The CRA performance evaluation criteria this book proposes in chapter eight have been developed based on the notion that while the CRA is not intended to allocate credit, it is intended to influence banks to lend more money in redlined neighborhoods, and it is permissible under the CRA to influence banks to lend in such areas up to the point of allocating credit.

Specifically, the CRA evaluative criteria this book proposes are composed of three characteristics that will maximize the CRA's potential for democratizing capital: quantitative measures of bank lending; quantitative benchmarks of community credit needs; and objective standards for determining whether bank lending meets credit needs. Such criteria would make it possible for community groups to hold banks accountable for poor CRA records and would help ensure that banks are distributing sufficient capital to meet community credit needs.

The reason the CRA has not met its potential for democratizing capital and exploring how it might do so is the story this book tries to tell. The story begins in chapter one, with the legislative history of the CRA. Congress passed the CRA to influence banks to make loans to redlined neighborhoods. Congress intended the CRA to eliminate the banking practice known as "redlining," which is the refusal to lend in low-income, predominantly minority, or inner-city neighborhoods, regardless of credit risk, and to increase bank lending in these neighborhoods. When Congress amended the CRA and other banking laws with CRA-related provisions on six separate occasions, it took a number of steps to strengthen the CRA's extension of the franchise over decisions about the distribution of capital, primarily through expanding the amount and quality of information about bank lending records that is available to the public. While Congress intended the CRA to influence banks to make more loans to redlined neighborhoods, Congress also stated that it did not intend the CRA to allocate credit, another way of stating that the CRA was not to be used to create lending quotas. Congress did not ban quotas, but the legislative history indicates that quotas are not permissible under the CRA.
Based on this legislative history, the federal banking agencies may adopt criteria for evaluating CRA performance that influence banks to lend up to the point of setting quotas.

Chapter two describes the structure of the CRA. Reflecting its legislative history, the CRA is designed to influence banks to lend more money in underserved neighborhoods without allocating credit. The CRA places an obligation on banks to help meet community credit needs. It creates an enforcement mechanism that influences banks to make loans to satisfy this obligation. Enforcement comes in the form of periodic evaluations of a bank's CRA record by the federal banking agency that regulates it, public disclosure of information about a bank's CRA record, and scrutiny of a bank's CRA record by the agency that regulates it when the bank submits an expansion application. The CRA does not, however, contain enforcement provisions that might lead to credit allocation, such as mandatory penalties for a bank that fails to satisfy its CRA obligations or the right of individuals to sue in court for CRA violations.

The story then moves, in chapter three, to the first CRA enforcement regime, which lasted from 1978 through mid-1997. In enforcing the CRA, the federal banking agencies—all of which had opposed the CRA—did not emphasize the portion of the CRA or its legislative history that focused on increasing lending to redlined neighborhoods. Instead, they focused on the portion of the legislative history that prohibited credit allocation. The agencies treated the CRA as a law that was intended to correct an information failure in the market. According to this theory, banks redlined because they decided it was not worth the expense or time to seek creditworthy borrowers in particular neighborhoods, especially LMI, inner-city, or predominantly minority communities. The agencies' perspective was that the CRA requires banks to seek information about lending opportunities in redlined neighborhoods and market loans there. The first set of CRA regulations, which were in force from 1978 through mid-1997, reflected this position. The criteria for evaluating CRA performance in the regulations and the agencies' enforcement of the CRA emphasized the efforts a bank undertook to make loans in its local community. A bank's actual lending was of secondary importance to its efforts to lend. When the agencies evaluated bank lending, they used vague and inconsistent criteria and subjective standards that made it impossible for members of the public to know what a bank's CRA obligations were, let alone hold a bank to them.

Over time, the first CRA enforcement regime generated great dissatisfaction. The regime had the unfortunate distinction of generating dissension among the banks it regulated, the residents of redlined neighborhoods that it was intended to benefit, and the law's enforcers, the federal banking agencies themselves. They all agreed that the CRA was enforced in an arbitrary and inconsistent manner. Bankers complained that it generated unnecessary burden and paperwork and subjected bank expansion plans to undue delay and expense. Community groups asserted that the federal banking agencies did not fulfill their responsibility to enforce the CRA and that the standards for evaluating bank lending were too vague and subjective to allow them to hold a bank accountable for a poor record of meeting community credit needs.

In response to the many criticisms of the first CRA enforcement regime, the federal banking agencies began a rule-making process in July 1993 that culminated in new CRA regulations in April 1995 that were fully phased in by July 1997. Chapter four describes the efforts to reform the CRA regulations. The new regulations made some improvements and some progress towards implementing criteria for evaluating CRA performance that consist of quantitative measures of bank lending, quantitative benchmarks of community credit needs, and objective terms for evaluating bank performance. Specifically, the second set of CRA regulations eliminated the criteria that evaluated bank efforts to lend and replaced them with criteria that evaluated a bank's lending, investment, and service performance. The regulations require the federal banking agencies to consider the extent of the bank's lending in its community, the geographic distribution of its loans, and its lending to persons of different income levels. However, the regulations do not spell out clearly and unambiguously how to measure bank lending, how to measure community credit needs, or how to evaluate whether the lending meets credit needs. Thus, despite the improvement, the new regulations fall short of fulfilling the capital-democratizing promise of the CRA.

The first proposed draft of the new regulations, however, came very close to utilizing quantitative measures and benchmarks and objective standards for evaluating CRA performance. It had a "market share" test, which would have evaluated a bank's record of meeting community credit needs by comparing a bank's market share of loans in LMI neighborhoods (quantitative measure of bank lending) with its overall market share of loans (quantitative benchmark of the bank's ability to meet overall community credit needs). If the bank's market share in LMI neighborhoods was "comparable" to its overall market share, it presumably was meeting community credit needs. There was also a loan-to-deposit ratio ("LDR") test, pursuant to which the percentage of a bank's deposits that it returned to the community in the form of loans (quantitative measure) would be compared with a 65% LDR (quantitative benchmark). An LDR of 65% was presumably reasonable (a quasi-objective standard). Finally, the proposed regulations evaluated the percentage of a
INTRODUCTION

If a majority of loans were in the bank's community (quantitative benchmark), this was "appropriate." The banking industry criticized the market share and LDR tests as allocating credit, and the federal banking agencies dropped them from the final regulations.

The failure of the federal banking agencies to adopt CRA regulations that use criteria for evaluating CRA performance composed of quantitative measures and objective standards means the CRA still has a long way to go before reaching its potential for democratizing capital. This is borne out in chapter five, which investigates how the federal banking agencies have implemented the second set of CRA regulations. Chapter five examines CRA performance evaluations, agency decisions on bank expansion applications, and the agencies' CRA examination manuals and other regulatory materials. Despite improvements in the second set of CRA regulations, the agencies continue to enforce the CRA in a way that makes it nearly impossible for community groups to hold a bank accountable for a poor lending record. The agencies did not use a fixed set of CRA evaluative criteria, frequently employed criteria consisting of a quantitative measure of bank lending and a quantitative benchmark of community credit needs but used subjective standards to compare bank lending with the benchmark, did not define the level of performance required to meet a particular subjective standard, used the subjective evaluative standards inconsistently and almost always in a way that favored banks, and did not define the weight each criterion had. The agencies' decisions on expansion applications similarly did not use a fixed set of criteria and used subjective standards for evaluating bank lending. The decisions generally listed facts about the bank's lending, emphasized strengths and excused weaknesses, and did not describe the reasoning the agency employed in reaching the decision. Finally, the compliance manuals do not require banking agency examiners to use a fixed set of criteria when evaluating a bank's CRA performance.

The story next moves to chapter six, which examines the impact the CRA has had on distributing loans to LMI and minority persons and neighborhoods. There is substantial evidence consistent with the conclusion that the CRA has encouraged banks to lend more money to LMI and minority persons and neighborhoods than they would have without the CRA. Nevertheless, there is evidence that the CRA has not realized its potential. LMI and minority neighborhoods receive a disproportionate share of costly subprime and predatory loans; many residents of such neighborhoods who received sub-

prime loans could have received a prime loan; and a large percentage of the LMI persons do not even have a bank account.

The book then moves to its final two chapters, which examine whether it is possible to create CRA evaluative criteria that do not allocate credit and are composed of quantitative measures of bank lending, quantitative benchmarks of community credit needs, and objective standards for evaluating whether bank lending meets community credit needs. Chapter seven examines other federal government interventions in the credit markets in order to define credit allocation more specifically and to distinguish governmental credit allocation from governmental efforts to influence bank lending decisions. Several examples show this difference, including the Department of Justice's enforcement of the fair-lending laws, laws and regulations governing Fannie Mae and Freddie Mac, laws establishing lending requirements for banks with interstate branches, and home mortgage-lending disclosure laws.

Finally, chapter eight proposes CRA evaluative criteria that maximize the CRA's potential for democratizing capital. The criteria are composed of quantitative measures of bank lending, quantitative benchmarks of community credit needs, and objective standards for evaluating whether bank lending meets community credit needs. Chapter eight demonstrates that the proposed criteria will strengthen the franchise over lending decisions that the CRA extends to previously disenfranchised community members, will influence banks to lend more money to LMI and minority persons previously excluded from the economic system, and will not allocate credit.
CHAPTER ONE

THE LEGISLATIVE HISTORY OF THE CRA

Introduction

The legislative history of the Community Reinvestment Act ("CRA") shows that the purpose of the CRA was to end the bank practice known as redlining—refusing to lend in certain neighborhoods, especially low-income, predominantly minority, and inner-city neighborhoods—due to perceived credit risks, and to increase the amount of money banks lend in their local communities in general and in redlined neighborhoods in particular. The CRA expresses a congressional preference for banks to make loans in their local communities and in LMI neighborhoods and threatens sanctions for banks that do not comply. In using the CRA to express a preference and threaten sanctions, Congress intended to influence banks to lend more money in redlined neighborhoods.

The legislative history of the CRA also shows that in passing the CRA, Congress did not intend to create a system of government-imposed credit allocation, and equated credit allocation with lending quotas. Congress did not establish lending quotas, require banks to lend to particular persons or organizations, or create mandatory sanctions for failing to lend.

Based on the legislative history, the four federal agencies that regulate banks (the "federal banking agencies" or the "agencies") may promulgate CRA regulations that contain criteria for evaluating the CRA performance of a bank that consist of quantitative measures of bank lending, quantitative benchmarks of community credit needs, and objective standards for evaluating whether bank lending meets community credit needs.

The difference between allocating credit and influencing bank lending decisions is not just semantic. It is the difference between setting mandatory quo-
The Purpose of the CRA

Congress passed the CRA in light of evidence that banks were engaged in two interrelated practices—redlining and capital export—which, CRA's supporters argued, contributed to the deterioration of inner-city neighborhoods. Redlining is the practice by which a bank draws a red line around a neighborhood on a map and refuses to lend there because of perceived credit risks associated with the neighborhood. Capital export is the practice by which a bank exports the deposits of one neighborhood's residents to other communities and makes loans in those other communities despite local lending opportunities. Congress identified several different types of neighborhoods as being victimized by these practices, including LMI, minority, urban and inner-city, older, and rural and small towns (collectively "redlined neighborhoods"). Senator William Proxmire, the CRA's primary sponsor, described these related practices:

[B]anks and savings and loans will take deposits and instead of reinvesting them in that community, they will invest them elsewhere, and they will actually or figuratively draw a red line on a map around areas of their city, sometimes in the older neighborhoods, sometimes ethnic, and sometimes black, but often encompassing a great area of their neighborhood.

The legislative history contains several examples of redlining. Senator Proxmire stated, "The data provided by that act [the Home Mortgage Disclosure Act] remove any doubt that redlining indeed exists, that many creditworthy areas are denied loans." Senator Proxmire cited several examples: banks in Brooklyn invested only 11% of their deposits in Brooklyn; banks in Washington, D.C. invested 90% of their deposits outside of the city; Los Angeles, Chicago, Cleveland, and St. Louis suffered from disinvestment. According to a survey of Washington, D.C. banks conducted by the Senate Committee on Banking, Housing, and Urban Affairs, one bank had a policy of making no home mortgage loans and a savings and loan made 99% of its home mortgage loans in the suburbs. According to CRA's supporters, when banks export capital, they fail to meet local credit needs for housing, small businesses, and farms, to the detriment of these communities. "We also know that small town banks sometimes ship their funds to the major money markets in search of higher interest rates, to the detriment of local housing, to the detriment of small business, and farm credit needs." Senator Proxmire stated, "This denial of credit, while it is certainly not the sole cause of our urban problems, undoubtedly aggravates urban decline." Senator Proxmire seemed to take moral offense at redlining and capital export: "[T]he banking industry must be encouraged to reinvest in local needs rather than continuing to favor speculative loans to shaky foreign regimes, to REITS [Real Estate Investment Trusts], to unnecessary supertanker fleets, to bank insiders, and all of the other questionable ventures that have managed to get credit while our local communities starve." He asserted that many of
Similarly, Congress indicated that the success of federal development programs "depends in large part upon the availability of private capital, particularly as made available through local lending and financial institutions." As Senator Proxmire stated, "[I]t is possible that the Federal Government may put in a few billion dollars this year or over the next few years to help rebuild our cities. But it will be peanuts compared to what the financial institutions can put into them if they have the will to do it." 45

When he introduced the CRA, Senator Proxmire justified the effort to influence banks to lend in redlined neighborhoods as a quid pro quo. 46 He stated that the public charter that banks receive justifies imposing public obligations on banks. 47 "[A] public charter conveys numerous economic benefits and in return it is legitimate for public policy and regulatory practice to require some public purpose." 48 He listed several benefits of a bank charter. Banks enjoy protection against competition from other businesses. Banks hold a "semi-exclusive franchise." 49 Senator Proxmire elaborated, "The Government limits the entry of other potential competitors into that area if such entry would unduly jeopardize existing financial institutions." 50 The government also restricted "competition [among banks] by limiting the rate of interest payable on savings deposits and prohibiting any interest on demand deposits." 51 The government provides low-cost deposit insurance. 52 Finally, the government provides low-cost credit through the Federal Reserve Banks and the Federal Home Loan Banks. 53

CRA Enforcement

Criteria for Evaluating a Bank’s Record of Meeting Community Credit Needs

The legislative history contains a discussion about how to evaluate a bank’s record of meeting the credit needs of the community. This discussion sheds light on the difference between allocating credit and influencing banks to lend more in redlined neighborhoods, further supports the proposition that Congress intended the CRA to influence banks to lend in redlined neighborhoods, and provides some guidance regarding criteria for evaluating CRA performance that influence banks to lend in redlined neighborhoods but do not allocate credit.

As initially introduced, the CRA included a mandatory loan-to-deposit ratio for evaluating a bank’s record at meeting local credit needs. The CRA would have required banks to indicate, subject to regulatory approval, the percentage of their deposits that they would lend in their local communities. 54 However, Senator Proxmire dropped this provision in light of strong opposition that this mandatory loan-to-deposit ratio would have constituted credit allocation. 55

The CRA’s subsequent legislative history contains suggestions of the sorts of criteria the agencies could utilize in evaluating the CRA performance of a bank. Although not explicit, the discussions imply that it would be appropriate to adopt criteria for evaluating CRA performance composed of quantitative measures of bank lending, quantitative benchmarks of community credit needs, and objective standards for evaluating bank lending. For example, there is a suggestion that a bank’s lending could be evaluated by comparing its performance to demand, measured by all loan applications received by all banks in the community and the number of loans banks make in the community. 56 The legislative history also suggests a quasi-objective standard for evaluating whether a bank’s lending meets community credit needs: whether the bank is lending a “disproportionate” amount of credit outside the community. 57 Although the term “disproportionate” is not precise and is open to interpretation, the legislative history contains some guidance about its meaning. The Senate Report states that although Congress “rejected the course of setting percentage targets for reinvestment, it should be self-evident that an institution exporting 99 percent of its dollars outside of the city in which it is chartered is not serving community convenience and needs.” 58

The report cited one bank that had gone from making 1% of its loans in 1974 in its city to 20%. 60 In the Senate debates on the CRA, Senator Proxmire stated that Brooklyn and Washington, D.C. were suffering from disinvestment; banks in those areas were lending 89% and 90% of their deposits, respectively, elsewhere. 61 Finally, a colloquy between Senator Proxmire and Vincent J. Quinn, president and chairman of the board of the Brooklyn Savings Bank, suggests that “disproportionate” might be defined by comparing a bank’s performance with other banks’ performances based on their relative sizes. According to Senator Proxmire, Brooklyn Savings Bank, with $1.1 billion in assets, made 52 loans in Brooklyn in 1975, compared with the smaller GreenPoint Bank, which made 722 loans. 62 Quinn defended Brooklyn Savings Bank by asserting that there was not sufficient demand for loans in Brooklyn for all banks to originate the same percentage of their assets in loans in Brooklyn as GreenPoint Bank. 63 Proxmire responded by stating, “[W]hen you compare
these, it looks as if this bank [GreenPoint] was more aggressive and active and serviced its community more effectively than your large bank did."64

Arthur Burns, former chairman of the Federal Reserve, outlined similar criteria the federal banking agencies would have to utilize if the CRA were enacted.65 The federal banking agencies would have to identify the credit needs of the community, determine the extent to which they were being met, and determine whether a particular bank was doing its share. Burns opposed the CRA on the grounds that this would be unduly burdensome.66

Sanctions for Failing to Meet Community Credit Needs

Another way the legislative history of the CRA sheds light on the difference between allocating credit and influencing bank lending decisions and further indicates that Congress did not intend to allocate credit but did intend to influence banks to lend in underserved neighborhoods is Congress' consideration of sanctions for banks that do not satisfy their CRA obligations. Instead of imposing the sort of mandatory lending orders on a bank for failing to satisfy its CRA obligations that would accompany credit allocation, the sanction was "relatively weak."67 Senator Proxmire stated, "You're not going to put a bank out of business if they don't loan locally."68 Congress intended the federal banking agencies to use their authority to "encourage financial institutions to help meet local credit needs."69

Despite the fact that there were no mandatory sanctions, the agencies' encouragement was to be strong. The CRA required the federal banking agencies to "use the full extent of their authority...to encourage all regulated depository institutions' responsiveness to community needs."70 Representative Ashley, a CRA supporter in the House, stated that the CRA "reaffirms and strengthens the powers of the federal financial supervisory agencies to assure that federally regulated financial institutions meet the credit needs of their communities."71

The legislative history indicates that this regulatory encouragement was to be both formal and informal. As to formal encouragement, the federal banking agencies would use their authority when examining banks and considering bank expansion applications to encourage them to lend in their communities.72 According to Senator Proxmire, a poor CRA record would be grounds for denying an application, but this remedy was not mandatory. "We provided that when a bank wanted to open a branch the regulating agencies would have to take into account how much they invested locally, and they might have this as a decisive consideration under some circumstances."73 An example from the legislative history of a formal effort was a state banking regulator that required city banks that wanted to open a branch in the suburbs to "emphasize lending to their inner city areas as a precondition for approval of the new suburban branch."74

As to informal encouragement, Senator Proxmire stated, "the record shows we have to do something to nudge them, influence them, persuade them to invest in their community."75 The legislative history cites examples of instances in which regulatory persuasion resulted in increased lending.76 In one case, the Federal Home Loan Bank Board, responding to complaints that a savings and loan in Washington, D.C. made 99% of its mortgage loans outside the District, urged the savings and loan to take affirmative steps to increase lending there.77 As a result, the savings and loan increased its proportion of lending in the District to 20%.78 According to the Senate Report, other branches in the District were able to make 80% of their loans there with no "adverse effect," thus the "Bank Board's suggestion that the [savings and loan] take affirmative steps to publicize the availability of credit to city residents was appropriate under the circumstances...."79

Opposition to the CRA

The opponents of the CRA, including the heads of three of the four federal banking regulatory agencies,80 had several objections to the CRA. Primarily, they argued that the CRA was or would lead to credit allocation, and they equated credit allocation with credit quotas. During the Senate Hearings, Senator Tower stated, "This proposal would, as I read it, provide for a scheme of credit allocation...."81 According to the opposition statement in the Senate Report, "The enactment of this Section would have adverse effects upon the free flow of capital within our economy, and a rose by any other name is still 'credit allocation,'"82 According to Senator Morgan, the CRA:

is a significant step in the direction of credit allocation by the Congress of the United States. If bills of this nature are pushed to their ultimate conclusion, then the day will come when a financial institution may be forced to make an unsound loan in a specific location in order to meet its quota of loans in a given locality.83

Senator Lugar stated, "This perennial attempt to provide credit allocation, to provide by law some reason why loans must be made at the penalty of losing the business, is simply a gesture in futility,"84 Senator Tower stated, "I do not
think that we should indulge in the authorization or, indeed, the mandate of a system of credit allocation...”83 Senator Schmitt argued that the CRA “is a step in the direction of credit allocation by Government agencies.”86

According to the CRA’s opponents, credit allocation was undesirable because it unduly interfered with the free market and could force banks to make unsound loans. Credit allocation “created barriers to the free flow of funds to places they are needed.”87 The CRA’s opponents described the United States as a constantly shifting “patchwork of capital short and capital surplus localities” that had been overcome, in large part, by the standardization of mortgage documents, the secondary mortgage market, and the weakening of geographic lending limits.88 The free flow of funds ensured that money would go to the areas where it would get the highest return, guaranteed that the supply of mortgage funds would be constant where needed, and reduced the cost of mortgages by guaranteeing mortgage money would be available even in areas where the demand for mortgage loans was greater than the supply of money to make mortgages.89 The CRA, opponents argued, by “overemphasizing the need to meet local credit needs will discourage the free flow of funds and disrupt the flow of credit from capital surplus areas to capital short areas.”90 The CRA “would be a step backward, encouraging the creation of barriers to the free flow of funds to places they are needed.”91 Senator Tower argued, “Nothing could militate more strongly against the vitality of a market-regulated economy than a growing system of credit allocation.”92 Finally, the CRA would force banks to make risky loans, and rather than doing this, banks would leave the neighborhoods the CRA intended them to serve.93

Similar arguments were made two years earlier when Congress considered the Home Mortgage Disclosure Act (“HMDA”), which required lenders to disclose the location of their real estate-related loans.94 Opponents of HMDA argued that it would allocate credit. HMDA’s opponents characterized credit allocation as a quota.95 They argued that credit allocation would have the same negative effect: “Quota systems are a form of credit rationing. This means we would be taking from someone, the small business or the suburban homeowner, and giving to someone else, in this case the inner city homeowner.”96

The opponents of the CRA made other arguments as well. They argued that the bill did not define key terms, did not contain standards for evaluating regulations.97 The CRA, they argued, would require “bank examiners to assess the institution’s record of meeting the credit needs of its primary service area yet, the bill sets out no criteria or guidelines upon which this assessment is to be based.”98 Opponents argued that it would be impossible to define a proper reinvestment ratio.99 They also argued that the law would burden banks with additional paperwork.100 They believed that voluntary efforts to increase lending were preferable and already underway.101 Opponents argued that the CRA was unnecessary because other federal laws, such as the Home Mortgage Disclosure Act, the Equal Credit Opportunity Act, and the various provisions of the federal banking laws that required banks to meet the convenience and needs of their communities, prohibited redlining.102

Finally, recognizing that one purpose of the CRA was to increase lending in redlined neighborhoods, the CRA’s opponents claimed it would have the opposite effect.103 It “would...have the adverse effect of causing a reduction in credit availability in these areas which we are trying so desperately to revitalize.”104 They argued that the CRA would deter banks from entering areas in need of revitalization for fear of the obligation to meet local credit needs.105 In a letter to Senator Morgan, former Federal Reserve Chairman Arthur Burns stated, “to the extent that this or any other sanction should prove effective in causing credit to flow substantially into an area on the basis of non-market forces, entry by depository institutions into other similar areas would likely be discouraged.”106 Similarly, Senator Schmitt stated:

The requirement that financial regulatory agencies allocate credit under this or any other scheme can have adverse effects. By forcing financial institutions to make loans of dubious quality, the Congress would easily convince financial institutions to close branches in decaying neighborhoods and thus, lead to further economic and social decline in these areas.107

Finally, opponents argued that the CRA’s additional paperwork and bureaucracy would further discourage banks from opening branches in redlined areas.108

Response to the CRA’s Opponents

CRA supporters denied that it allocated credit, and in making this denial confirmed that the CRA would influence banks to lend more in redlined neighborhoods. The Senate Report states:

Charters have never constituted licenses to ignore local credit needs. Therefore, the Committee rejects the assertion that this Title allocates credit. It simply underscores the long-standing obligation to an institution’s local service area implicit in existing law.109
Amendments to the CRA

Congress made nine significant amendments to the CRA or other banking laws on six different occasions. Congress intended the first five amendments to refine and strengthen the CRA's influence over bank lending decisions. Three of these five amendments influence banks to lend more in redlined neighborhoods by expanding CRA-related public disclosure requirements. The sixth and seventh amendments strengthened the CRA by expanding it to cover the formation of financial conglomerates. The eighth and ninth amendments were adopted to weaken the CRA's influence. The eighth amendment requires banks and community groups to disclose CRA agreements they make and the ninth reduces the frequency of CRA examinations of small banks with satisfactory or better CRA records.

FIRREA Amendment

In the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"), Congress amended the CRA to require that the federal banking agencies disclose to the public their written CRA performance evaluations of banks, the CRA ratings they assigned to banks, and the facts upon which the ratings were based. Prior to this, the written evaluation and rating were confidential. Congress intended public disclosure of the CRA performance evaluation reports to strengthen CRA enforcement "by allowing the public to know both what regulatory agencies are telling depository institutions and what the community reinvestment records of particular depository institutions are." Congress intended this amendment to reiterate the purposes of the CRA, tighten CRA standards, and influence banks to make more housing, small business, and small farm loans. The amendment "will help to ensure that financial institutions in communities across our Nation will remain viable and active members of the very communities they serve." FIRREA's legislative history also provides guidance about the types of credit Congress was especially interested in influencing banks to make available. Congress indicated that CRA performance evaluations should place special emphasis on a bank's record "of serving the housing credit needs of low- and moderate-income persons, small business credit needs, small farm credit needs, and rural economic development." Thus, FIRREA's amendments to the CRA, among other FIRREA provisions, "return[ed] savings and loans to their original purpose, mortgage lending, including for low- and moderate-income people."
FDICIA Amendment

In the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"),129 Congress amended the CRA once again in an attempt to strengthen its ability to influence bank lending decisions.130 FDICIA expanded on FIRREA's disclosure requirements by requiring the federal banking agencies to disclose the data that support their conclusions about the bank's CRA rating.131 Combined with FIRREA's disclosure requirements and its support of more housing, small business, and small farm loans, FDICIA's provision other strengthening of CRA's influence over bank lending decisions. It does so by helping to define and disclose the standards the federal banking agencies use to evaluate a bank's record at meeting community credit needs. As the Senate Report on the amendment stated:

Disclosure will make it possible for interested parties (e.g., Congress, community organizations, depository institutions, state and local officials) to determine the underlying standards and criteria regulators use to evaluate and rate CRA performance. Such parties will then be better able to determine how much credibility and weight they should assign to a particular CRA evaluation or rating. The Committee intends that, over time, implementation of the amendment should bring greater uniformity and consistency to the CRA process.132

HCDA and RTCA Amendments

Congress amended the CRA as part of the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991 ("RTCA")133 and The 1992 Housing and Community Development Act of 1992 ("1992 HCDA").134 These amendments state that in assessing a bank's CRA record, the federal banking agencies could consider lending and investment activities undertaken by banks in cooperation with minority- and woman-owned banks in order to meet the credit needs of the bank's community.135 Under the RTCA and 1992 HCDA amendments, the federal banking agencies may consider as a positive factor a bank's lending activities in underserved communities. These provisions can be seen as an attempt to use the CRA to influence banks to assist minority- and woman-owned banks and low-income credit unions, presumably because these financial institutions, in turn, could be counted on to help meet the credit needs of redlined neighborhoods.

Riegle-Neal Amendment

As part of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, which allowed banks to open branches in more than one state, Congress amended the CRA to require the federal banking agencies to prepare a separate CRA performance evaluation for each state in which a bank with interstate branches has at least one branch.137 Congress passed this amendment to alleviate concerns that banks would use interstate banking to siphon deposits from new states in which they opened branches to make loans in their home states.138 Congress stated that this provision ensures that the principles of the CRA would be followed in interstate banking.139 "Communities need not fear that increasing geographic opportunities for banks will deprive them of needed capital....These provisions are designed to ensure that banks will not just vacuum up deposits in some States and reinvest them in other States."140

GLBA Amendments

The Gramm-Leach-Bliley Act of 1999 ("GLBA"), which repealed the Glass-Steagall Act and certain provisions of the Banking Act of 1933,141 and amended the Bank Holding Company Act of 1956 and other federal banking laws that had prohibited banks from engaging in the securities and insurance businesses,142 also amended the CRA and other related laws.143 Three CRA-related amendments prohibit banks from engaging in the insurance or securities businesses unless they received at least a satisfactory rating on their most recent CRA examinations, require banks and community groups to disclose the terms of CRA agreements they enter, and limit the frequency of CRA examinations of small banks.144 These CRA-related provisions of the GLBA reflect a compromise between supporters of the CRA, who hoped to extend it to the new businesses in which banks could engage,145 and Senator Phil Gramm, who hoped to limit the CRA's influence.146 As such, the GLBA's effect on the CRA's ability to influence banks to lend in redlined neighborhoods is mixed. Under the GLBA, a bank holding company ("BHC") must become a financial holding company ("FHC") to engage in the securities or insurance businesses, but a BHC is not permitted to form an FHC unless all of the BHC's bank subsidiaries received at least satisfactory ratings on their most recent CRA evaluations.147
Conclusion

The legislative history of the CRA shows that in passing the CRA, Congress intended to influence banks to lend more in LMI, minority, and inner-city neighborhoods. Congress passed the CRA in light of evidence that banks had redlined these neighborhoods and exported their capital elsewhere. In light of this, the CRA has a dual purpose—to end redlining and to increase lending in redlined neighborhoods. Supporters of the CRA made clear, however, that while it was intended to influence banks to lend more in such neighborhoods, the CRA was not intended to create a system of government-imposed credit allocation. With two exceptions, amendments to the CRA and related banking laws generally strengthened the CRA's influence, primarily through increasing the amount of information available about bank lending and requiring the federal banking agencies to focus on home mortgage, small business, and small farm lending when evaluating banks for CRA compliance.

CHAPTER TWO

THE LEGAL STRUCTURE OF THE CRA

Introduction

Reflecting congressional intent as expressed in its legislative history, the CRA is structured in a way that influences banks to lend in their local communities and in low- and moderate-income ("LMI"), predominantly minority, and inner-city neighborhoods (collectively "redlined" neighborhoods), but does not set quotas or force them to allocate credit. However, while the CRA explicitly states that banks have an obligation to meet credit needs, it does not explicitly ban credit allocation. This suggests that the federal banking agencies may enforce the CRA in a way that broadly defines the affirmative obligation on banks to meet credit needs but narrowly defines credit allocation.

The CRA states that banks have an affirmative obligation to help meet the credit needs of their local communities, including LMI neighborhoods, without specifying how much a bank must lend. The CRA requires the federal banking agencies to examine individual banks periodically to assess their records of helping to meet credit needs, to publish an evaluation report—including a rating—for each bank, and to take the bank's record into account when considering an application by the bank to expand. Members of the public can file comment with the agencies on these applications. The agencies can deny an application because the bank has not met its CRA obligations. The CRA thus democratizes capital by influencing banks to lend more to redlined communities and by giving these communities a voice in bank lending decisions. But the CRA does not do this by allocating credit. The CRA does not impose specific lending targets on banks. It does not set lending quotas or specify the amount of credit banks are to make available, to whom, for what purpose, or on what terms. The CRA does not contain mandatory penalties for a bank that fails to meet community credit needs.