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The question of "Financial Modernization: What's in it for Communities?" can be approached in at least two ways. One is to consider the "financial modernization" bill, passed by Congress last November and signed into law by the President shortly thereafter, and its effect on the Community Reinvestment Act (CRA). A second approach is to look at the trends underway in the financial services industry and the changes that industry spokespeople view as creating a more modern financial services system in this country; then, analyze how those changes are affecting low and moderate income communities.

To the extent that we are talking about the Gramm-Leach-Bliley Financial Services Modernization Act, and in the context of the Community Reinvestment Act (CRA), the answer for the communities has to be, "Not much," or at least, not much that's good.

Gramm-Leach-Bliley (GLBA)[1] is a law that is the culmination of a twenty-year effort in Congress. The Act not only addresses the major priorities of most sectors of the financial services industry, but was also largely written by the industry. GLBA dismantles a structure that has been in place since the Great Depression. It is, by any measure, one of the most important pieces of legislation in the 20th Century affecting the financial services industry.

Yet, during the debate over this bill, there was virtually no discussion of how such a major public policy vehicle could, should, or would be used to further the public interest. There were token assurances that the public would have "better, cheaper, and faster" access to financial services, but little real effort to make sure that this was true.

Therefore, although CRA figured large during the deliberations, and generated much heat and publicity; it should come as no surprise that the attention did not translate into legislative

[1] Gramm-Leach-Bliley Financial Services Modernization Act of 1999, Pub. L. No. 106-102, 113 Stat. 1338 (1999) (codified at 15 U.S.C. 6801 *et seq.*) [hereinafter GLBA]. The GBLA was intended to "enhance competition in the financial services industry by providing a prudential framework for the affiliation of banks, securities firms, insurance companies, and other financial services providers." *See* H.R. CONF. REP. NO. 106-434 (1999).

provisions designed to insure "better, cheaper, faster" access to financial services in this "modernized" world tolow income people and communities..

What did we get in this bill? We got a modest provision designed to insure that bank holding companies, and now financial holding companies, cannot completely abandon service to low income people and communities in their quest for new financial services horizons. This is the provision that sets, as a standard for eligibility to become a financial holding company, the requirement that existing depository institutions, owned by the holding company, must have satisfactory or better CRA ratings at the time the parent elects FHC status, or at the time it commences any new business activities authorized by the bill[2]. This is a useful statement of public policy, and will surely have some impact. However, the impact should not be overplayed: since approximately 98% of banks and thrifts now receive satisfactory or better ratings, this provision is not likely to result in noticeable differences in local communities. The provision also falls short of what Chairman Leach[3] would have us believe is the application of CRA to the insurance and securities branches of the financial services industry. These industry segments will not come under any community reinvestment obligations, nor does the bill provide any handles for community groups to address the insurance and securities activities of the new financial holding companies.

[2] *See* GBLA tit. I, §§ 103(a) (amending Sec. 4 of the Bank Holding Company Act of 1956 by adding a new subsection (l)(2)), 103(b) (amending Sec. 804 of the Community Reinvestment Act of 1977). Through the rulemaking process, the Federal Reserve Board has diluted the prohibition against financial holding companies commencing new activities if one of their banking subsidiaries has a less-than-satisfactory CRA rating. In the preamble to the revised version of Regulation Y (12 C.F.R. pt. 224; Doc. Nos. R-1057, R-1062, released December 12, 2000), the Federal Reserve Board stated its belief that, " . . . this language [in GLBA] is best read to apply only when an insured depository institution receives a less-than-satisfactory CRA rating while it is under the control of the FHC." (*See* Preamble Regulation Y at 14). Thus, when Citigroup recently acquired the Associates, which owned a bank with a "Needs to Improve" CRA rating, the FED held that, because Associates National Bank received that rating prior to its acquisition by Citigroup, its status with respect to CRA would not bar Citigroup from launching any new financial activities.

[3] Rep. Jim Leach (R-IA), Chairman of the House Banking Committee and chairman of the joint House-Senate conference committee on S. 900.

Other provisions of the bill look worse. GLBA changes the CRA exam cycle for small banks — those with assets under $250 million — to five years for banks with outstanding CRA ratings and four years for banks with satisfactory ratings[4]. These changes are unlikely to yield any tangible benefits for banks, who will still have other exams (safety and soundness and other consumer compliance exams) on shorter cycles, and whose CRA exams will simply cover longer time periods. Yet, by lengthening the time between CRA exams, these changes may have a detrimental impact on the public, particularly in rural communities where small banks play a more significant role than in many urban areas.

The so-called "CRA Sunshine" language in GLBA is another problematic provision[5]. This is the section that requires parties to "CRA agreements" to disclose the text of the agreement, report annually on funds paid and received, and activities conducted under the agreement, and subject them to various penalties for failure to comply with these requirements. The federal banking regulators have yet to finalize regulations to implement this provision, so the details remain to be seen.[6] Nonetheless, the "Sunshine" provision is likely to have a chilling effect on CRA activity. It will discourage community groups from participating in the regulatory process, which has been fundamental to CRA's success over the years. Furthermore, it will undoubtedly discourage the partnerships that have grown up between banks and community groups, which have been the vehicle through which CRA's benefits have been realized in local communities all across the country.

This chilling effect appears to be just what the key sponsors of the provision intended;[7] and, makes it vital that the regulators take to

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[4] See GBLA tit VII, § 712 (amending the Community Reinvestment Act to add a new sec. 809 entitled, "Small Bank Regulatory Relief").

[5] See GBLA tit VII, § 711 (amending the Federal Deposit Insurance Act to add a new Sec. 48).

[6] Proposed regulations to implement the CRA Sunshine provisions in GLBA were issued jointly by the four federal banking regulatory agencies in May, 2000. See Disclosure and Reporting of CRA-Related Agreements, 65 Fed. Reg. 31961 et. seq. (proposed rule) (May 19, 2000). The comment period closed on July 21, 2000. As of mid-October, no final rule had been promulgated.

[7] See, e.g., Gramm Urges Thrifts to Refuse Demands for Cash in CRA Disputes, American Banker, March 8, 2000.

heart the language in the conference report, crafting regulations that will minimize the reporting burden for banks, community groups and others caught in the "Sunshine" web. Unless they do this, and perhaps even if they're successful in minimizing the reporting burden, this provision raises serious First Amendment issues. It also undermines the regulators' ability to carry out their CRA enforcement obligations effectively, and furthers Senator Gramm's anti-CRA crusade.

Banks were remarkably silent on this issue during the legislative debate. However, this is an area where their interests and those of community groups are very similar. Hopefully themutual interest will be reflected in the comments the industry submits on the proposed regulations.

The bill also calls for two CRA-related studies. One, assigned to the Treasury Department, requires that agency to assess the impact of the legislation on CRA-related activity.[8] The report is due two years after enactment, although the Department is required to report baseline information to Congress by May 15, 2000. At this point, details about this report have not been made public.[9]

The second study is assigned to the Federal Reserve Board,[10] to assess defaults and delinquencies in "CRA loans," and evaluate the profitability of those loans. The Board collects the necessary information through a voluntary survey of financial institutions, and releases a draft of the proposed survey instrument. The draft raises some grave concerns. For example, it asks a series of questions about banks' experiences with various loan program and products, and asks the respondents to indicate whether their answers are based on actual data or whether they are "educated guesses." Any time a survey form

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[8] See GBLA tit VII, § 715 (requiring the Secretary of the Treasury to study "the extent to which adequate services are being provided as intended by the Community Reinvestment Act of 1977, including services in low- and moderate-income neighborhoods and for persons of modest means, as a result of the enactment of this Act.").

[9] *See* Robert E. Litan, Nicolas P. Retsinas, Eric S. Belsky, and Susan White Haag, The Community Reinvestment Act After Financial Modernization: A Baseline Report, Treasury Report (issued April 19, 2000). The report focused primarily on mortgage lending trends in 305 U.S. cities between 1993 and 1998. *Id.*

[10] *See* GBLA tit. VII, § 713 ("Federal Reserve Board Study of CRA Lending"). The Board released its study, "The Performance and Profitability of CRA-Related Lending" in July, 2000.

offers respondents the opportunity to guess at their answers, one has to wonder what the final results will show. However, regardless of the final results of this study, we can be sure that Senator Gramm will use them to continue his attack on CRA.

Let's go back to the original question: what does "financial modernization" offer to communities, specifically low and moderate income communities and communities of color? Answering this question requires us to take a look at broader trends in the world of financial services. These changes were reflected in the GLBA, but they predated it, and would likely have continued even if the Act was not passed. How these changes will play out for all of the different sectors of the financial services world and the communities they serve, is not yet clear. But, in trying to anticipate the impact that these changes will have, it may be helpful to think about what they will mean for the future implementation of CRA, which has been the primary tool available to communities to insure access to quality, affordable financial services. A look at the key elements of "financial modernization" highlights some of the limits of CRA, and the ways in which it, too, must be modernized.

One of the major trends underway in financial services is consolidation. For some time now, banks have been getting bigger and bigger as mergers and acquisitions proliferate. Post-GLBA, we may see bigger and bigger financial services companies, combining not just banking but other financial services under one corporate roof. Even before GLBA, and just within the banking sector, the effects of consolidation on CRA are striking.

The centerpiece of CRA, in many ways, is the CRA rating, which is intended to be a reflection of each institution's performance in helping to meet the credit needs of the community it is chartered to serve. Each bank and thrift gets a single CRA rating on a four-point scale ranging from Outstanding to Substantial Non-compliance. When the law was enacted in 1977, the one-rating-per-bank system was a reasonable way to provide some indication of bank performance. At that time, no one envisioned a single institution with branches from coast to coast, serving thousands of local communities. Yet, it is impossible for a single CRA rating to effectively capture a large institution's performance in each of the communities in which it has a presence. Inevitably, the performance of large institutions will vary from place to place. They will be doing a better job in some places and a comparatively worse job in others. For the largest banks, the one-rating-per-bank system no longer provides an effective indication of how good or poor a job the bank is doing under CRA, in any given community. As a consequence, it is also no longer an effective way to hold those institutions to a consistently high standard across all of their markets.[11]

One of the most important outcomes of CRA in the last twenty or so years has been the relationships that it has fostered between banks and thrifts, and community groups and public officials in their local communities. These relationships have led to the development of innovative programs and products to address particular local needs and conditions. Yet, by many reports, these relationships have suffered as a result of bank consolidation. In some ways, this comes as no surprise. Large institutions are, by their very nature, less flexible. They tend to centralize decision-making in a few locations. This provides for consistency, but also means that decision-makers may not be familiar with important details of the many geographic markets the bank serves.

Large institutions have a hard time managing many different programs and relationships, particularly when dispersed over large geographic areas. Quality control is a great challenge under such circumstances. For a large institution, it is easier to develop a set of standardized products that can be offered in every community. In effect, the community may be asked to mold itself to the bank's

[11] There is some precedent for the federal banking regulators denying a CRA-covered application on the basis of the appicant' egregiously bad performance in a single community, even though its performance has been rated as satisfactory in its other communities. For example, see, the Federal Reserve Board's order denying the application of First Interstate BancSystem of Montana, Inc. to merge with Commerce BancShares of Wyoming, Inc., October 7, 1991. At the time, First Interstate was the third largest commercial banking organization in Montana, and Commerce was the fourth largest in Wyoming. Both were multi-bank holding companies. The denial was based on the inadequate CRA performance of a single First Interstate Bank in Colstrip, Montana, which accounted for only a small portion of the overall deposits of the applicant. The Colstrip bank had received a less than satisfactory CRA rating because it essentially redlined the Northern Cheyenne Indian Reservation. However, this standard of holding an institution accountable for the "weakest link" in its CRA performance has not been applied widely, either by the Federal Reserve or the other agencies.

product offerings, rather than the reverse. Large institutions, may more easily establish relationships with a small number of intermediary organizations, rather than trying to keep up with local contacts in many markets, which is a fairly labor intensive undertaking. Centralization and standardization make efforts easier for the bank, but undermine the flexibility that has been so important to the success of CRA. For banks, all of these trends make perfect sense. Banking regulators are unlikely to challenge them, and indeed, may support them. But for local community organizations and local public officials, these effects of consolidation may diminish the usefulness of CRA as a tool for addressing their particular local credit needs.

A second trend that is troublesome, from a CRA perspective, is the increasingly complex corporate structures that characterize financial services companies. Take the mortgage lending business as an example. When CRA was enacted in 1977, mortgages were generally made by banks, savings and loans, or mortgage companies. For the most part, these were separate institutions with separate ownership. These days, we have these three types of lenders, along with finance companies, making mortgage loans, under the same corporate roof. The result is that affiliates of the same parent company may be offering similar products in the same communities, competing with their corporate brothers and sisters. As the law is currently interpreted, the type of company (insured depository institution vs. other) determines whether activities are subject to CRA review, not the type of activity. A loan that would be reviewed under CRA, if offered by a bank or thrift, escapes scrutiny if offered by that bank or thrift's mortgage company, finance company, or other affiliate. The only exception to this rule occurs when the insured depository opts to rely on the record of an affiliate as part of its own CRA performance review.

A bank performing a modest level of mortgage business in low income or minority areas, and its finance company affiliate marketing very aggressively in those same communities and capturing a much larger share of the market, is not uncommon. Sometimes, we see the bank helping people build assets and wealth, while its affiliate may be stripping wealth away through predatory lending practices.

Even where this worst case scenario does not exist, the company may be hard pressed to make sure that the customer ends up with the best (that is, lowest cost and lowest risk) product for which he or she qualifies. In fact, it is not at all clear that those in the business feel any obligation to make sure that the customer ends up with the best product available from among the various corporate affiliates – bank, thrift, mortgage company, or finance company. At the same time, the customer may be hard pressed to distinguish between the various affiliates, especially when they carry the same name. He or she may not understand the advantages or disadvantages of doing business with a bank, compared to a mortgage company, or compared to a finance company. Instead, that customer may walk through the door of the corporate affiliate that is most aggressive in seeking his or her business, may end up with a less advantageous or even disadvantageous product, and never know the difference. So far, CRA has not proven to be an effective tool in addressing this situation.

A third force at work in the world of financial services, and one that is actually a catalyst for many of the other changes underway, is technology. In many ways, technology has transformed the way banks do business. In fact, one could argue that technology is transforming the kind of business that banks do. It is hard to overstate the profound impact of technology on financial services.

For low and moderate income people, technology offers the promise of lower costs and greater access. According to figures from the Office of the Comptroller of the Currency, a check deposited with a teller costs a bank approximately a dollar ($0.95) to process, while a similar transaction conducted over the Internet costs the bank $0.01.[12] One would think that such a dramatic cost reduction would open up new possibilities for providing affordable banking services to low and moderate income people.

However, the promise of technology is not a self-fulfilling one. The technology itself is a barrier for many people, as all of the

[12] *See* Karen Furst, William W. Lang, and Daniel E. Nolle, *Technological Innovation in Banking and Payments: Industry Trends and Implications for Banks*, Office of the Comptroller of the Currency, Quarterly Journal, Vol. 15, No. 3, September 1998, at 28.

work on the so-called "digital divide" has amply demonstrated. To take advantage of the savings that might be available by banking over the Internet, a customer must first have a telephone, a computer and a modem. He or she must also know how to use them and be comfortable transacting banking business through this medium. These barriers may eventually be overcome, but they won't come down by themselves. It will take a concerted effort by financial institutions, regulators, community groups and others to make technology work in a way that lowers cost and increases access to financial services for low and moderate income people.

There is another, less promising, side to technology as well. It offers businesses the ability to collect and analyze information about their customer bases in much more detail than ever before. This means they can more easily identify those customers who are the most profitable, and those who are the least profitable. Technology also affords them ways to distance themselves from – if not actively discourage – those whose business is less desirable. This is reflected in the periodic reports of institutions that decide to charge low balance customers extra fees for talking face-to-face with a teller. Another example, that comes up periodically in the press, is the institution that codes customer accounts according to their profitability. When customers call into the bank's automated phone system, the calls from those whose accounts are coded as the most profitable are sent to the front of the queue, while those who are least profitable face seemingly interminable waits.[13] Clearly, technology is a double-edged sword.

In the context of CRA, technology presents a particular dilemma, because it offers banks ways to deliver services that don't require customers and banks to be in the same location or even the same time zone. Information management systems, remote access devices and the Internet all make it possible for customers to interact with banks from far away, at virtually any hour of day or night. This kind of relationship is radically different from the relationship that existed between banks and their customers in 1977, when CRA became law. In those days, most transactions between banks and their customers occurred in a bank branch. Therefore, the branch served as

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[13] *See, e.g.*, Ken Elkins, *More Banks Sorting Customers*, American City Business Journals, Inc., October 13, 1997.

a reasonable proxy for customer location, and the area around bank branches provided a reasonable definition of a bank's local communities. This geographic relationship between bank branches and bank customers, and indeed a geographic definition of community, is the building block of CRA, as it was the building block of the bank charter (since banks are chartered to serve the convenience and needs of their local communities).

One of the effects of technology is that a bank's community can no longer be defined in strictly geographic terms, and bank branches do not necessarily serve as a good proxy for the location of a bank's customers anymore. Some banks exist primarily in cyberspace, and others serve many of their customers in that medium.[14] Yet, CRA as it is currently constituted, cannot account for activity in cyberspace; it flies completely under the "CRA radar." We need new ways to capture community for purposes of delineating a bank's obligations under CRA and evaluating its performance in serving those communities.

A fourth trend underway in the financial services field, that has implications for low income communities, is the new affiliations formed between banks and other types of financial services providers. This is what GLBA was all about: allowing many types of financial service firms under one corporate roof with very few restrictions. Perhaps the most well-known of these new combinations is Citigroup, the $600+ billion behemoth created by the merger of the Citicorp bank holding company and the Travelers Group insurance conglomerate. This merger took place even before GLBA became law, and for some in Congress, Citigroup seemed to be the beacon of a new era in financial services. In the few years before the "financial modernization" legislation was enacted, we also saw a raft of insurance companies and securities firms acquiring thrift institutions; thereby taking advantage of a somewhat obscure provision of law that

[14] In fact, 36% of all Internet banking customers in the U.S. do not have accounts with Internet-only banks, but rather with Wells Fargo, Bank of America, Bank One, Citibank or First Union. *See* Karen Furst, William W. Lang, and Daniel E. Nolle, *Who Offers Internet Banking?*, Office of the Comptroller of the Currency, Quarterly Journal, Vol. 19, No. 2, June 2000, at 45. No statistics are currently available on the extent to which these customers are located in communities where those banks also have brick and mortar branches. *Id.*

provided them this foothold in the world of banking. In the wake of GLBA, it seems likely that we will see many other corporate combinations, although perhaps few that capture the headlines like Citigroup.

As with technology, these new affiliations offer new ways of delivering financial services. In addition to, or in place of, the traditional bank branch, companies will be able to use insurance agents or stockbrokers to sell banking products. Like technology, these new channels of service delivery pose challenges for CRA enforcement.

Take, for example, State Farm, the major insurance company. State Farm now owns an insured depository institution: State Farm Financial Services, F.S.B. The bank operates in Illinois, with plans to expand operations into two other states and ultimately nationwide. State Farm has 16,000 or so insurance agents all across the country. These agents will be used as an outlet for selling the bank's products. Not only will you be able to get car insurance or homeowner's insurance, or the like from your State Farm agent, but you will also be able to get credit cards, car loans and leases, home purchase loans, home equity loans, checking accounts, savings accounts, money market accounts, CDs, etc. In other words, the company is simply expanding the range of products its agents can offer to customers nationwide. In addition, State Farm is also marketing its banking products directly to its insurance customers through the mail and on its website.

However, while State Farm and its agents may be selling banking products nationwide, State Farm Bank will only be evaluated for CRA purposes in the one community where its only office is located. Just like Internet banks, activity conducted elsewhere simply flies under the CRA radar screen; it basically does not count. Thus, in many — in fact, most — communities where State Farm Bank is doing business, its performance in helping to meet the credit needs of low and moderate income people will simply never come under review.[15] The same is true for other insurance companies that own

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[15] State Farm was one of several insurance companies that made CRA-related commitments to the Office of the Thrift Supervision (OTS) as part of its application for a thrift charter. State Farm agreed to make, within three years of launching its operations,

banks or thrifts and use their insurance agents as substitutes for bank branches. This is also true for banks or thrifts owned by securities firms that use their stockbrokers to market their banking products. Clearly, these new delivery channels create a problem for effective CRA enforcement.

Another challenge posed by the new affiliations authorized by GLBA, is how to create a corporate commitment to CRA and a corporate culture and infrastructure to support community reinvestment and community development activities. Banks have learned, (some might say the hard way) over several decades, how to do this business and what benefits it brings. Insurance companies and securities firms have not. The question for community groups may be how to instill in such companies the commitment to serving low and

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$195 million in loans to low- and moderate-income borrowers in the three states in which it planned to initially operate. After the first three years, State Farm agreed to an annual goal of CRA-related loan commitments and activities equal to the greater of 5% of its assets or the amount of its deposits generated in low- and moderate-income areas.

OTS conducted its first CRA examination of State Farm Financial Services, FSB (SFFS) in March, 1999 and released the public portion of the exam report in May, 1999. It gave the institution a "Satisfactory" CRA rating. OTS noted that 79% of SFFS' lending activity occurred *outside* of its CRA assessment area, which is defined as the Bloomington-Normal, Illinois MSA.

OTS examiners analyzed the extent to which the 21% of SFFS loans, service, and investments made within its assessment area helped to meet the needs of that community, and found the institution's performance "marginally acceptable."

With respect to the 79% of the SFFS' loans made outside its assessment area, OTS profiled the income levels of the borrowers (but not the census tracts) and asserted that SFFS' performance on this measure was "relatively strong" with respect to mortgage loans, and "good" with respect to consumer loans, although it does not provide the public with any indication of what benchmarks it used to reach this conclusion. In its analysis of these consumer loans, the agency noted that, "A factor in this distribution is that insurance agents are mainly located in middle and upper income census tracts. This limits SFFS' ability to generate loan volume in the lower income tracts." (*See* SFFS CRA Evaluation, at 15 (March 20, 1999)). Nothing in the exam report indicates that OTS expected SFFS to take any steps to address this imbalance.

OTS did not identify the communities in which any of these outside loans were made. It did not provide any analysis of the credit needs of those communities or measure the institution's performance relative to those needs. Nor did it compare SFFS' performance to any other lenders active in those communities. All of these would have been part of a traditional CRA analysis.

Further, OTS did not analyze SFFS' performance outside of its assessment area under the service test. Nor did it even comment on the fact that SFFS did not make any qualified CRA investments outside of its assessment area.

moderate income people. The companies also have to learn: how to develop the local relationships that are fundamental to any understanding of the credit needs of low income people and communities; how to develop products to address those needs effectively; how to build the infrastructure to deliver those products; and how to insure that those loans and services actually get out on the street.

Clearly, these dramatic changes underway in the world of banking and the broader world of financial services pose serious challenges for low and moderate income communities. CRA remains the primary public policy tool available to those communities to help them gain access to the financial mainstream. But, equally clearly, CRA was not crafted with today's world in mind; it is far from a perfect fit. CRA was designed to address the issues of its day and represented the vision of community groups and Congress for a banking system that served everyone in America.

We now face a new day, in a "modernized" financial services world. This requires a new vision of how today's world can be structured to meet the financial services needs of everyone in America. We face the challenge of putting tools in place that are appropriate for the task in front of us now. We need a "modernized" CRA.

Just like the mid-1970's, community groups all across America are taking on that challenge. Where CRA does not work, groups will find other avenues to bring about change. At the same time, they will continue to push Congress to enact the tools needed to make sure that low income communities are not left in an economic backwater. And, I am confident that the day will come when a modernized CRA becomes a reality.