

January 2008

## The Community Reinvestment Act at 30: Looking Back and Looking to the Future

John Taylor  
*National Community Reinvestment Coalition*

Josh Silver  
*National Community Reinvestment Coalition*

Follow this and additional works at: [https://digitalcommons.nyls.edu/nyls\\_law\\_review](https://digitalcommons.nyls.edu/nyls_law_review)

 Part of the [Banking and Finance Law Commons](#), [Business Organizations Law Commons](#), [Law and Economics Commons](#), and the [Legislation Commons](#)

---

### Recommended Citation

John Taylor & Josh Silver, *The Community Reinvestment Act at 30: Looking Back and Looking to the Future*, 53 N.Y.L. SCH. L. REV. 203 (2008-2009).

This Article is brought to you for free and open access by DigitalCommons@NYLS. It has been accepted for inclusion in NYLS Law Review by an authorized editor of DigitalCommons@NYLS.

JOHN TAYLOR AND JOSH SILVER

## The Community Reinvestment Act at 30: Looking Back and Looking to the Future

**ABOUT THE AUTHORS:** John Taylor is President and CEO at the National Community Reinvestment Coalition (“NCRC”), and Josh Silver is NCRC’s Vice President of Research & Policy. The NCRC is an association of more than 600 community-based organizations that promote access to basic banking services, including credit and savings to create and sustain affordable housing, job development, and vibrant communities for America’s working families. Its members include community reinvestment organizations, community development corporations, local and state government agencies, faith-based institutions, community organizing and civil rights groups, minority and women-owned business associations, and local and social service providers from across the nation.

## INTRODUCTION

The Community Reinvestment Act (“CRA”) is a comprehensive law that has leveraged substantial amounts of loans, investments, and bank services for the benefit of minority and working-class neighborhoods. It has been indispensable in creating and maintaining affordable housing and economic development in low- and moderate-income (“LMI”) communities nationwide. As we recently celebrated the CRA’s thirtieth anniversary, this article will describe how the CRA works, its accomplishments to date, and ways in which policy makers can contribute to its continued effectiveness.

Passed in 1977, the CRA imposes a “continuing and affirmative obligation” on banks to “help meet the credit needs of the local communities in which they are chartered.”<sup>1</sup> Congress passed the CRA in response to the practice of “redlining,” or the refusal of banks to lend in minority and working-class communities. Not only has the CRA successfully held back discrimination, it has required banks to proactively assess and serve community needs. The CRA’s mandate to serve needs in a safe and sound manner has been vital and is especially important today as our nation faces a foreclosure crisis caused in substantial part by irresponsible lending. CRA-covered depository institutions (banks and thrifts) have been shown to have engaged in less risky lending than institutions not covered by the CRA.

Sections I and II of this article will first discuss how the CRA works and the CRA’s accomplishments to date. Sections III, IV, and V of the article will discuss how to strengthen CRA by improving the CRA examination process, ratings system, and merger application process. Sections VI and VII will examine the adequacy of anti-discrimination reviews on CRA exams and advocate for more frequent CRA exams for small banks. It will also discuss how the CRA could be applied to non-bank financial institutions as well as the need to extend the CRA to non-bank financial institutions. A number of the suggestions for bolstering the CRA are provisions from the CRA Modernization Act of 2007.<sup>2</sup> The Conclusion will offer an outline of the proposals for improvement set out in this article.

### I. HOW THE CRA WORKS

The CRA statute requires four federal agencies to conduct CRA evaluations and to consider depository institutions’ CRA performance when depository institutions apply for permission to merge or open bank branches. The four agencies that conduct CRA exams are the Federal Reserve Board (for state-chartered banks), the Office of the Comptroller of the Currency (for nationally-chartered banks), the Office of Thrift Supervision (for federally chartered thrifts), and the Federal Deposit Insurance Corporation (for state-chartered banks and thrifts). A CRA exam evaluates the extent to which banks respond to local community needs and assigns a rating based on the federal agency’s assessment of the bank’s responsiveness to needs. CRA

---

1. 12 U.S.C. § 2901 (2006).

2. *See* Community Reinvestment Modernization Act of 2007, H.R. 1289, 110th Cong. (2007). NCRC worked closely with the staffs of Rep. Eddie Bernice Johnson (D-Tex.) and Rep. Luis Gutierrez (D-Ill.) in the drafting of the bill.

exams and ratings are publicly available.<sup>3</sup> The agencies conduct CRA exams for banks with assets above \$250 million once every two or three years. Banks with assets below \$250 million undergo CRA exams once every four or five years.<sup>4</sup> Banks receive one of four ratings: “Outstanding,” “Satisfactory,” “Needs to improve,” and “Substantial non-compliance.” The last two are considered failing CRA ratings.<sup>5</sup>

CRA exams differ according to the asset size and type of bank undergoing examination. Exams differ according to bank size as follows. Large banks with assets of more than \$1 billion undergo the most rigorous exams comprising the following component parts:

- Lending Test—an evaluation of the extent to which various loans are reaching LMI borrowers and neighborhoods. Loans include home and small business loans and community development loans.
- Investment Test—an evaluation of the number and responsiveness of investments in LMI neighborhoods. These include investments in Low-Income Housing Tax Credits or Small Business Investment Corporations.
- Service Test—an evaluation of a bank’s provision of branching and bank services in LMI neighborhoods.<sup>6</sup>

Intermediate small banks—banks with assets between \$250 million to \$1 billion—have a streamlined CRA exam that consists of a lending test and a community development test only.<sup>7</sup> The community development test combines elements of the investment and service tests.<sup>8</sup> Small banks with assets below \$250 million have an even more streamlined CRA exam that consists only of a lending test.

---

3. See, e.g., Federal Financial Institutions Examination Council, <http://www.ffiec.gov/craratings/default.aspx>. (last visited Oct. 25, 2008).

4. The Gramm-Leach-Bliley Act of 1999 mandates that the frequency of CRA exams for small banks with assets below \$250 million depends on their most recent rating. Small banks with a “Satisfactory” rating will undergo a CRA exam in four years; small banks with an “Outstanding” rating will undergo a CRA exam in five years. See 12 U.S.C. § 2908 (2006).

5. Although “Needs to improve” and “Substantial non-compliance” are both considered to be failing ratings, “Substantial non-compliance” is a lower level of performance. For example, the appendix to the CRA regulations uses the adjective “very poor” to describe “Substantial non-compliance” performance while “poor” describes “Needs to improve” performance. 12 C.F.R. pt. 345, app. A (2008).

6. A large bank can score “Low” or “High Satisfactory” on its component tests but its overall rating is limited to the four ratings stated above.

7. Intermediate small bank asset levels are adjusted every year to account for inflation. For the most recent adjustment, see Community Reinvestment Act Regulations, 72 Fed. Reg. 72,571, 72,574 (Dec. 5, 2007) (to be codified at 12 C.F.R. pt. 563e).

8. For a more complete description of exams for intermediate small banks, see Josh Silver & Richard Marsico, *An Analysis of the Implementation and Impact of the 2004–2005 Amendments to the Community Reinvestment Act Regulations: The Continuing Importance of the CRA Examination Process*, 53 N.Y.L. Sch. L. Rev. 271 (2008).

CRA tests also differ according to the type of bank being examined. Banks that do not accept retail deposits and have narrow product lines such as credit card lending (wholesale or limited purpose banks) are evaluated based on the quality and quantity of their community development lending and investments.<sup>9</sup> Finally, any bank or thrift can opt for a strategic plan in lieu of a CRA exam. Within a strategic plan, a depository institution provides numerical targets for its lending, investments, and services; the federal agency evaluates the extent to which that depository institution meets its goals.

When a bank wishes to merge with another bank or open an additional branch or branches, it must submit an application to the appropriate federal agency. The federal agency considers a variety of factors in deciding the application, including a bank's record in serving the convenience and needs of communities under the CRA. A federal agency can deny or delay a merger or branch application based on poor performance in meeting any of the factors considered in the application process. Denials of merger applications on CRA grounds are rare, but delays occasionally occur while a bank answers various questions about its past CRA performance or makes specific promises to improve CRA performance. A federal agency can issue a conditional approval of a merger application under which an application is approved, but a bank is required to take certain steps to address a CRA or other deficiency.

The public comment process is a vital component of CRA exams and reviews of bank applications. Community organizations and members of the general public can comment on CRA exams and merger applications. Because federal agencies are required to consider public comments in issuing CRA ratings and rendering decisions on merger applications, community groups can have practical impacts on ratings and merger outcomes. Thus, public input on CRA exams can spur banks to improve their CRA performance.

## II. THE CRA'S RECORD IN INCREASING ACCESS TO BANK LENDING AND SERVICES

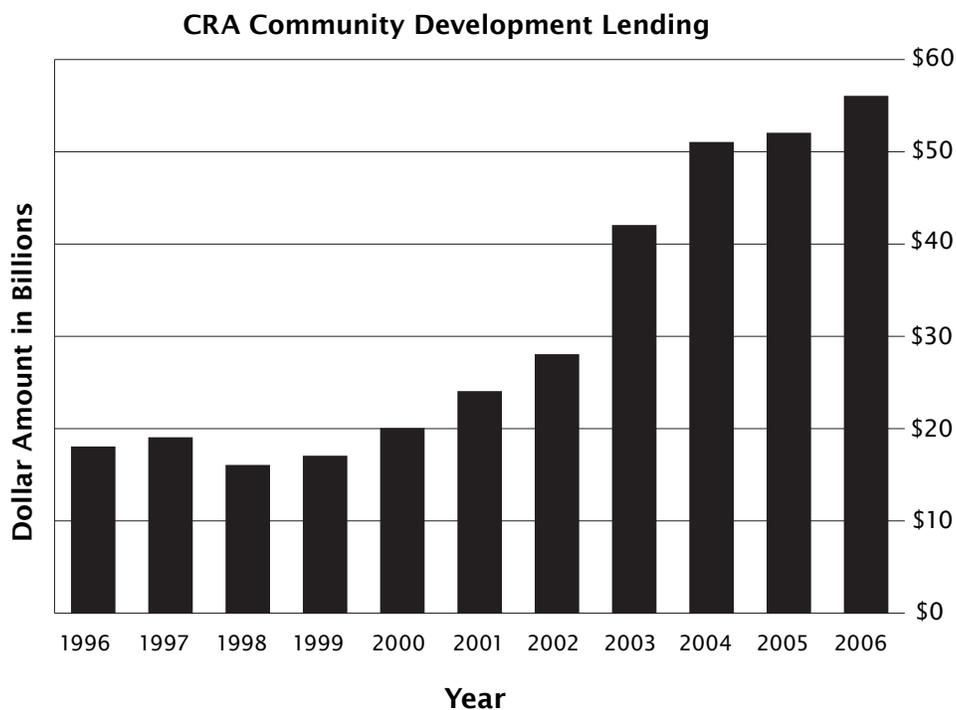
The CRA has leveraged substantial numbers of loans, investments, and bank services for the benefit of LMI communities through its public accountability mechanisms. In addition, banks have realized that lending, investing, and serving LMI communities is a profitable way of doing business.

According to publicly available data analyzed by NCRC, banks and thrifts (depository institutions) have made over 340,000 community development loans totaling more than \$344 billion since 1996. From 1996 to 2006, the annual dollar amount of community development loans increased by 219%—from \$17.7 billion to \$56.5 billion respectively. During this same period, depository institutions also made 12,433,172 small business loans in LMI neighborhoods totaling more than \$513 billion.

---

9. The discussion in this section is based on the CRA regulation, see 12 U.S.C. § 2901 (2006), the interagency Question and Answer document, see 66 Fed. Reg. 36,620, 36,624–52 (July 12, 2001), available at <http://www.ffiec.gov/cra/qnadoc.htm>, and NCRC's CRA Manual, available at [http://www.ncrc.org/images/stories/pdf/cra\\_manual.pdf](http://www.ncrc.org/images/stories/pdf/cra_manual.pdf).

The CRA merger application process has motivated banks to make \$4.6 trillion in CRA agreements and commitments to LMI and minority communities. As described in NCRC's *CRA Commitments* publication, CRA agreements are often negotiated between banks and community groups during the merger application process. Banks seek to demonstrate to the federal agencies and the public-at-large that their lending and investing after a merger will increase. Banks therefore issue CRA commitments, pledging to offer specific numbers of affordable home loans, small business loans, community development investments, and branches in working-class and minority communities.<sup>10</sup>



Overall, banks make considerably more home loans in geographical areas covered by CRA agreements than those that are not.<sup>11</sup> This was documented in a study conducted by Federal Reserve economists using NCRC's CRA database. The incentives provided by CRA encourage banks to seek out opportunities in previously underserved markets. According to the Treasury Department, CRA-covered lenders increased home mortgage loans to LMI borrowers by 39% from 1993 to 1998. This

10. See NAT'L CMTY. REINVESTMENT COAL., *CRA COMMITMENTS 7* (2007), available at [http://www.ncrc.org/images/stories/whatWeDo\\_promote/cra\\_commitments\\_07.pdf](http://www.ncrc.org/images/stories/whatWeDo_promote/cra_commitments_07.pdf).

11. Raphael W. Bostic & Breck L. Robinson, *Do CRA Agreements Influence Lending Patterns?* 31 REAL EST. ECON. 23, 23 (2003).

increase is more than twice that experienced by middle- and upper-income borrowers during the same period (17%).<sup>12</sup> Likewise, a study by the Joint Center for Housing Studies at Harvard University estimates that without the CRA, 336,000 fewer home purchase loans would have been made to LMI borrowers and communities between 1993–2000.<sup>13</sup> The study also reveals that banks issue a greater number of loans to LMI borrowers in geographical areas covered by CRA exams than in areas not covered by the exams.<sup>14</sup>

The CRA's effectiveness can also be measured by comparing the lending patterns of CRA-covered banks and non-CRA covered lending institutions. Data suggests that banks make a greater percentage of their loans to minorities and LMI borrowers than non-CRA covered mortgage companies and credit unions. NCRC's analysis of Home Mortgage Disclosure Act ("HMDA") data found that CRA-covered depository institutions made 5.8% of their home purchase loans to low-income borrowers, while non-CRA lenders issued only 4.8% of these loans to the same group in 2005. Depository institutions and non-CRA covered lenders made 25.1% and 23.8% of their home purchase loans respectively to low- and moderate-income borrowers in 2005. Also, in 2006, depository institutions extended 23.5% of home purchase loans to LMI groups, whereas non-CRA covered lenders extended 21.5%.<sup>15</sup>

NCRC's study in 2005, *Credit Unions: True to Their Mission*, shows that over the three-year time period of 2001 through 2003, banks consistently outperformed credit unions in offering home loans to minorities, women, and LMI borrowers in a majority of states.<sup>16</sup> The study also found that in Massachusetts (one of two states with CRA requirements for credit unions) state-chartered credit unions that followed the CRA guidelines served LMI, minorities, and female borrowers at a rate significantly greater than non-CRA federally-chartered credit unions.

The CRA has remained true to its statutory purpose of requiring banks to serve credit needs consistent with safety and soundness.<sup>17</sup> In fact, the CRA can be an important antidote to the predatory and unsafe lending that has contributed to the

- 
12. ROBERT E. LITAN, NICHOLAS P. RETSINAS, ERIC S. BELSKY & SUSAN WHITE HAAG, *THE COMMUNITY REINVESTMENT ACT AFTER FINANCIAL MODERNIZATION: A BASELINE REPORT* (2000), available at <http://ustreas.gov/press/releases/reports/crareport.pdf>.
  13. See JOINT CTR. FOR Hous. STUDIES, HARVARD UNIV., *THE 25th ANNIVERSARY OF THE COMMUNITY REINVESTMENT ACT: ACCESS TO CAPITAL IN AN EVOLVING FINANCIAL SERVICES SYSTEM* 59 (2002), available at <http://www.jchs.harvard.edu/publications/governmentprograms/cra02-1.pdf> (noting that CRA lenders originated 42,000 more loans each year on average than would have been originated without CRA).
  14. *Id.* Banks are generally not subject to CRA exams in geographical areas in which they engage in lending through brokers, as opposed to branches.
  15. The data reported here is based on NCRC's calculations of the HMDA data.
  16. Press Release and Study, NCRC, *Credit Unions: True to their Mission?* 4 (May 19, 2005) (on file with NCRC).
  17. Bd. of Governors of the Fed. Reserve Sys., *THE PERFORMANCE AND PROFITABILITY OF CRA-RELATED LENDING* 89 (2000), available at <http://www.federalreserve.gov/boarddocs/surveys/craloansurvey/cratext.pdf>.

current foreclosure crisis. In its review of HMDA data, the Federal Reserve has found that home loans issued by banks are significantly less likely to be high-cost and exhibit risky features such as piggyback lending than those made by non-bank institutions.<sup>18</sup> The Federal Reserve Board showed that 34.3% of the home purchase loans issued by non-CRA covered lenders were high cost loans in 2005.<sup>19</sup> By contrast, only 5.1% of the home purchase loans issued by depository institutions that were closely scrutinized on CRA exams were high cost. These findings were corroborated by Traiger & Hinckley LLP which observed that 33.5% of the loans issued by non-CRA covered lenders were high-cost, as opposed to only 11.5% of the home purchase loans issued by CRA covered institutions in 2006.<sup>20</sup>

Research has not fully explained why CRA-covered institutions issue fewer high-cost loans, but it confirms that they do. One factor may be that CRA-covered institutions are subject to a higher level of regulatory scrutiny than non-CRA covered institutions, including fair lending and safety and soundness evaluations. Compliance with the law and keeping a good reputation and relationships in the community may be sufficient motivating factors for banks to lend responsibly.

Another factor may be that the CRA encourages institutions to holistically meet community needs—from lending for homeownership to rental housing, basic banking, and small business lending. Under this rubric, banks are awarded points on CRA exams for preparing borrowers carefully for home loans by encouraging savings and by providing quality homeownership counseling. Non-CRA-covered institutions, by contrast, are not similarly encouraged to carefully respond to such needs nor to prepare community residents for homeownership.

While it is true that by holding depository institutions publicly accountable for meeting community credit needs the CRA process has resulted in increased access to credit and capital, improvements can and should be made to the entire process. Below, we discuss improvements that we believe are needed in CRA exams, the application process, and the responsiveness of banks and regulatory agencies to public input.

### III. HOW TO IMPROVE THE EXAMINATION PROCESS AND CRITERIA

To this point, we have demonstrated that the CRA's public accountability mechanisms have leveraged lending, investments, and services that benefit LMI communities. Yet, the full potential of the CRA has yet to be realized. While the overall framework of the CRA has been successful, certain aspects of the exam procedures are in need of reform so that the CRA can continue to be effective and grow

---

18. In piggyback lending, borrowers simultaneously receive a first-lien mortgage and a junior-lien loan. Robert B. Avery, Kenneth P. Brevoort & Glenn B. Canner, *The 2007 HMDA Data*, available at <http://www.federalreserve.gov/pubs/bulletin/2008/pdf/hmda07draft.pdf>.

19. Robert B. Avery, Kenneth P. Brevoort & Glenn B. Canner, *Higher Priced Home Lending and the 2005 HMDA Data*, 2006 FED. RES. BULL. A123.

20. WARREN W. TRAIGER, *The Community Reinvestment Act: A Welcome Anomaly to the Foreclosure Crisis*, 53 N.Y.L. SCH. L. REV. 227, 230 (2008).

to realize its potential. The CRA Modernization Act of 2007 contains necessary reforms for various procedures. In other cases, such as enhanced analysis of bank branching and improved data, the federal regulatory agencies could directly implement the improvements suggested by NCRC without waiting for Congress to pass legislation.

Each of these issues will be discussed in turn.

#### *A. Assessment Areas*

Assessment areas are the geographical locations covered by CRA exams and generally consist of metropolitan areas or counties that contain the bank and its branches. When Congress enacted the CRA in 1977, banks received deposits and made loans through branches, and the majority of bank lending occurred through these branches. Today, banks utilize diverse channels for lending. While some banks still issue loans predominantly through branches, many others make the majority of their loans through brokers, correspondents, and other non-branch means.<sup>21</sup>

Though the CRA regulation stipulates that assessment areas include geographical regions containing bank branches, the regulation also states that assessment areas shall include geographical regions surrounding branches in which the bank has originated or purchased a substantial portion of its loans.<sup>22</sup> Despite the clarity of this regulatory clause, the federal agencies have largely adopted a narrow definition of assessment areas for banks or thrifts that issue most of their loans through non-branch channels. For these banks, it is not unusual to encounter CRA exams that cover only the geographical area of a bank's headquarters, thereby focusing on just a small percentage of a bank's lending patterns.

Data reveals that discriminatory and unsafe practices are more likely to occur when CRA exams have narrow assessment areas. In 2007, NCRC identified several lending institutions engaged in questionable practices, including: refusal to make loans under a minimum loan amount (usually \$75,000 or \$100,000), refusal to make loans to row homes, and failure to offer loans within entire cities (such as Baltimore and Philadelphia). For the banks engaged in these policies and practices, only 11 to 13% of the loans investigated were in the exam's assessment areas.<sup>23</sup>

Occasionally, federal agencies will review a sample of loans outside assessment areas to determine whether lending performance overall remains consistent with lending inside assessment areas. But the agencies sampled loans outside the assessment areas for only one of the four banks that NCRC investigated.<sup>24</sup> In general, the

---

21. See JOINT CTR. FOR Hous. STUDIES, *supra* note 13, at 13.

22. 12 C.F.R. § 345.41 (2008).

23. The data is on file with NCRC.

24. See Office of Thrift Supervision, CRA Performance Evaluation of Eastern Savings Bank, Docket #08183 (Aug. 22, 2005), *available at* [http://files.ots.treas.gov/cra/CRAE\\_08183\\_20050822\\_64.rtf](http://files.ots.treas.gov/cra/CRAE_08183_20050822_64.rtf) (noting that one institution for which the agencies examined lending outside of the assessment area was Eastern Savings Bank).

reviews of lending outside of assessment areas have not been satisfactory. The sample of loans reviewed usually consists of a small percentage of a bank's total loans.<sup>25</sup>

A bill introduced in the House of Representatives, HR 1289 or the CRA Modernization Act of 2007, addresses the inadequacies of assessment areas.<sup>26</sup> Under this bill, if a bank has captured one half of one percent or more of the local lending market, a CRA exam would be obligated to consider the geographical area served by the bank as an assessment area. A procedure such as this would ensure that a majority of a bank's loans were scrutinized by CRA exams. The majority of a bank's loans and purchases should be included on CRA exams so that the exams can effectively ensure that the loans are serving LMI populations in a safe, sound, and non-discriminatory manner.

### *B. Affiliates*

Under current CRA rules, a bank has the option of including its non-depository affiliates, such as mortgage companies, when responding to CRA exams. This procedure often leads to the "cherry picking" of affiliates to be included on CRA exams. Banks are tempted to include affiliates on CRA exams if the affiliates perform admirably but will opt against inclusion if the affiliates are engaged in risky lending or discriminatory policies. This runs counter to the essential purpose of CRA, which is to ensure that the institution as a whole is meeting credit needs responsibly.

Four non-depository affiliates of banks were identified by NCRC's fair lending investigations (discussed above) to be engaging in redlining or other discriminatory practices. These four affiliates were not included on their bank's CRA examinations. Current CRA examination procedures enable banks' affiliates to engage in such practices undetected. The CRA Modernization Act of 2007 would end this serious gap in CRA enforcement by mandating the inclusion of affiliates on CRA exams.

### *Combined Effects of Inadequate Procedures for Assessment Areas and Affiliates*

Inadequate procedures for assessment areas and affiliates often result in CRA exam coverage of only a small percentage of loans made by major lenders. NCRC's analyses have shown that in terms of the greatest number of loans issued, fewer than five of the top twenty lenders in a metropolitan area typically have a CRA exam measuring a bank's performance in that metropolitan area. In some cases, banks can represent half or more of the top twenty lenders, but their CRA exams' assessment areas do not examine results in that metropolitan area. Also, non-depository affiliates can be excluded from their CRA exams.<sup>27</sup>

---

25. See, e.g., Office of Thrift Supervision, CRA Performance Evaluation of Citicorp Trust Bank, Docket #14470 (Feb. 12, 2007), available at [http://files.ots.treas.gov/cra/CRAE\\_14470\\_20070212\\_64.rtf](http://files.ots.treas.gov/cra/CRAE_14470_20070212_64.rtf) (noting that just 21% of nationwide lending was scrutinized on the exam).

26. See Community Reinvestment Modernization Act of 2007, H.R. 1289, 110th Cong. (2007).

27. For example, in the Birmingham, Alabama, metropolitan area, NCRC found that of the 36,956 originations and purchases made by the top twenty lenders in 2006, only 3,456 or 9.4% were scrutinized

The Joint Center for Housing Studies at Harvard University conducted a national study with results that mirrored NCRC's analyses. The study found that just under 30% of the home purchase loans issued in 2000 were made by CRA institutions in CRA assessment areas.<sup>28</sup>

Fundamentally, the inadequate procedures for assessment areas and affiliates lead to the failure of federal agencies to implement the CRA's statutory purpose. The CRA intends that banks meet the credit needs of all communities in which they operate. Therefore, it is not sufficient for CRA exams to cover a minority of loans of a bank and its affiliates.

### *C. Minority Borrowers and Communities*

A bank's lending to LMI borrowers and communities is examined in detail on the lending test component of CRA exams. A major part of the lending test consists of scrutinizing the percentage of a bank's loans made to LMI borrowers compared with a) the demographics of the bank's community and b) the percentage of loans made to LMI borrowers issued by a bank's competitors. Tables in the exam provide a breakdown of these figures for home purchase lending, refinance lending, home improvement lending, and small business lending.

CRA exams have a fair lending component that assesses whether a bank has discriminated by rejecting qualified minority applicants or by steering minorities with good credit to subprime loans. While the fair lending review is necessary, it does not scrutinize whether banks are affirmatively making loans to minorities. In other words, a bank can employ non-discriminatory policies but still make relatively few loans to minorities because it does not actively market to minority communities. It may pass its fair lending review because it treated the few minorities who have applied to them for loans fairly, but it may still make very low percentages of its loans to minorities. If lending to minorities were made an explicit assessment criterion on CRA exams, consistently low percentages of loans to minorities in all loan types and geographical areas would contribute to a lower rating for the bank.

Given the evidence of lending disparities by race, NCRC has called for CRA exams to explicitly examine lending and other services to minority borrowers and communities. In our *Broken Credit System* report, we show that minority neighborhoods received larger percentages of subprime loans than predominantly white neighborhoods, even after controlling for creditworthiness and other housing stock characteristics.<sup>29</sup> Federal Reserve economists came to similar conclusions about high levels of subprime loans in minority neighborhoods after controlling for creditwor-

---

by CRA exams. Moreover, nineteen of the top twenty lenders were banks and non-depository affiliates of banks. Eleven of the largest institutions were banks. Of these eleven banks, only three of the banks' CRA exams included Birmingham as an assessment area. (Data on file with NCRC).

28. JOINT CTR. FOR HOUS. STUDIES, *supra* note 13, at 5.

29. NAT'L CMTY. REINVESTMENT COAL., *THE BROKEN CREDIT SYSTEM: DISCRIMINATION AND UNEQUAL ACCESS TO AFFORDABLE LOANS BY RACE AND AGE 6-7* (2003), available at <http://www.ncrc.org/images/stories/pdf/research/ncrcdiscrimstudy.pdf>.

thiness.<sup>30</sup> In our more recent report in 2007, *Income Is No Shield Against Racial Differences in Lending*, NCRC found that racial disparities in high-cost lending are great when comparing middle- and upper-income minorities with middle- and upper-income whites.<sup>31</sup> Finally, another NCRC study, *Are Banks on the Map?*, finds greater disparities in bank branches by race of neighborhood than by income of neighborhood in twenty-five large metropolitan areas.<sup>32</sup> In other words, the study found a small percentage of branches in minority neighborhoods compared with people in those neighborhoods; the gap between branches and neighborhoods was not as pronounced when considering low- and moderate-income neighborhoods in the metropolitan areas examined. NCRC hypothesizes that a lack of analysis in CRA exams of the racial makeup of neighborhoods has contributed to the greater disparities found in branches by race than by income of neighborhood.

Before the CRA regulatory reforms in the mid-1990s, CRA exams would often use HMDA data to assess performance of lending to minorities.<sup>33</sup> The changes to the CRA regulation in the mid-1990s simultaneously streamlined some aspects of CRA exams and made other aspects of CRA exams more rigorous and transparent. The agencies went too far in the direction of streamlining when they eliminated analyses of lending to minorities. Analyses of lending to minorities need to be on CRA exams, given the persistence of significant racial disparities in lending. If the regulatory agencies do not reinstate lending and service to minorities as criteria on CRA exams, then Congress should amend the CRA to add lending and service to minorities as proposed by the CRA Modernization Act of 2007.

#### *D. Evaluation of Branching*

Ensuring that LMI consumers have access to branches and deposit accounts is essential to encourage them to build relationships with banks, establish savings for down payments and collateral requirements, and prepare themselves for acquiring home or small business loans. Research conducted by the Federal Reserve Board demonstrated that banks offer a higher percentage of prime loans when they issue loans through branches rather than when they make loans through brokers.<sup>34</sup>

---

30. Paul S. Calem, Kevin Gillen & Susan Wachter, *The Neighborhood Distribution of Subprime Mortgage Lending*, 29 J. REAL EST. FIN. & ECON. 393 (2004); Paul S. Calem, Jonathan E. Hershaff & Susan M. Wachter, *Neighborhood Patterns of Subprime Lending: Evidence from Disparate Cities*, 15 HOUSING POL'Y DEBATE 603 (2004).

31. NAT'L CMTY. REINVESTMENT COAL., *INCOME IS NO SHIELD AGAINST RACIAL DIFFERENCES IN LENDING* 4 (2007), available at <http://www.ncrc.org/images/stories/pdf/research/income%20is%20no%20shield%20ii.pdf>.

32. NAT'L CMTY. REINVESTMENT COAL., *ARE BANKS ON THE MAP?* 17 (2007), available at [http://www.ncrc.org/images/stories/mediaCenter\\_reports/ncrc%20bank](http://www.ncrc.org/images/stories/mediaCenter_reports/ncrc%20bank).

33. An example of this approach is employed in the evaluation of Signet Bank conducted by the Federal Reserve Bank of Richmond in 1996. See Fed. Res. Bank of Richmond, *Community Reinvestment Act Performance Evaluation of Signet Bank* (Jan. 15, 1996), available at <http://www.federalreserve.gov/dcca/cra/1996/460024.pdf>.

34. See Avery, Brevoort & Canner, *supra* note 19, at A128, A157–58.

NCRC's research for the Appalachian Regional Commission similarly reveals that small business lending is higher in rural counties with a greater number of bank branches.<sup>35</sup> The provision of affordable products through branches is critical in assisting LMI-families to build wealth through increases in home and small business ownership. However, LMI and minority communities have a proliferation of payday lending outlets and other fringe lenders whose high fees hinder the ability to save and build wealth.

Because branching and access to basic banking services are vital to wealth building, the CRA service exam needs to be rigorous and comprehensive, holding banks to a high standard of branching and service provision in LMI neighborhoods. Research suggests that these exams have not been sufficiently rigorous. A study conducted by the Center for Community Capitalism concludes that CRA service test scores are likely to be inflated when low scores on the lending test and investment test confront banks with the possibility of CRA exam failure. The Center's econometric analysis is supported by qualitative analysis showing that banks with low lending and investment tests often receive "High Satisfactory" or better scores on the service test while offering few services and branches in LMI communities.<sup>36</sup>

The Woodstock Institute found lackluster service tests that did not hold banks accountable for branching and for offering community development services. For example, of the fourteen banks in Woodstock's sample that had the highest scores on the service test, eight had branch distributions in LMI communities that were well below the average branch distributions for all lenders in the banks' assessment areas. The exams were also inconsistent in providing data and detail on the level of bank services; some exams provided numbers of accounts and financial counseling seminars offered while others merely mentioned that the banks provided services.<sup>37</sup> In addition, as documented in the article by Marsico and Silver in this edition of the *New York Law School Law Review*, the new CRA exams for intermediate small banks are not adequately assessing bank branching in LMI neighborhoods.

Diminished attention to branching for intermediate small banks and the lackluster nature of the large bank service test should be addressed. The regulatory agencies should construct clear and objective measures for comparing the distribution of branches to the distribution of LMI neighborhoods and people in those neighborhoods. The agencies should collect data on the number and percent of deposit accounts in LMI neighborhoods so that CRA exams contain substantive

35. NAT'L CMTY. REINVESTMENT COAL., *ACCESS TO CAPITAL AND CREDIT FOR SMALL BUSINESSES IN APPALACHIA* 5 (2007), available at [http://www.ncrc.org/images/stories/mediaCenter\\_reports/ncrc%20study%20for%20arc.pdf](http://www.ncrc.org/images/stories/mediaCenter_reports/ncrc%20study%20for%20arc.pdf).

36. MICHAEL STEGMAN, KELLY COCHRAN & ROBERT FARIS, BROOKINGS INST., *CREATING A SCORECARD FOR THE CRA SERVICE TEST: STRENGTHENING BASIC BANKING SERVICES UNDER THE COMMUNITY REINVESTMENT ACT* 5 (2002), available at [http://www.brookings.edu/papers/2003/01childrenfamilies\\_stegman.aspx](http://www.brookings.edu/papers/2003/01childrenfamilies_stegman.aspx).

37. WOODSTOCK INST., *MEASURING THE PROVISION OF BANKING SERVICES FOR THE UNDERBANKED: RECOMMENDATIONS FOR A MORE EFFECTIVE COMMUNITY REINVESTMENT ACT SERVICE TEST* 4-7 (2007), available at [http://www.woodstockinst.org/index.php?searchword=Measuring+the+Provis&option=com\\_search&Itemid=](http://www.woodstockinst.org/index.php?searchword=Measuring+the+Provis&option=com_search&Itemid=)

analyses on the distribution of deposit accounts instead of mere assertions that banks provide services to LMI people. Similarly, including data on the number of financial counseling sessions and other community development services will enhance the rigor of community development services analyses.

*E. Data*

CRA exams cannot effectively measure banks' performance if data is of limited quality. Federal agencies have used the HMDA data in detail on exams, but further enhancements in the use of this data are needed. In contrast, the agencies' use and development of the CRA small business data has been lacking.

The agencies provide detailed tables on home loan lending. The narrative and tables on the CRA exams separately analyze home purchase, refinance, and home improvement lending. This is necessary since the different types of home lending respond to different credit needs. In other areas of analysis, however, the use of HMDA data should be enhanced on CRA exams.

Loan originations should be analyzed separately from data on purchases in order to bolster the integrity of CRA exams and to render it more difficult for banks to manipulate CRA exams through the buying and selling of loans.<sup>38</sup> According to community organizations, originating a loan is a more difficult task than purchasing a loan and should be weighted more heavily on CRA exams. While purchasing loans from other institutions can be helpful to the selling institutions, enabling them to make additional loans, a large secondary market for purchasing loans exists. Moreover, originating loans is usually a more complex task involving marketing and outreach, counseling borrowers through the process, and underwriting. At the least, these activities should be analyzed separately (in 2004 the agencies proposed separate data tables on originations and purchases only to abandon this proposal).<sup>39</sup>

The quality of HMDA data on loan purchases should be enhanced. Currently, Regulation C (the Federal Reserve regulation that implements the HMDA statute) requires data on loan purchases to include the census tract location of the property but not the race, gender, or income of the borrower.<sup>40</sup> Banks should be required to collect the same information on borrower and neighborhood characteristics on loan purchases as they do on loan originations. Some banks collect complete information on loan purchases while others do not. The rigor of CRA exams would be enhanced if data on loan purchases was made uniform.

CRA exams should use the new pricing information in HMDA data to separately evaluate prime and high-cost lending. Just as home purchase and refinance lending responds to different credit needs so too do prime and high-cost lending. Also, it is important to ensure that banks making both prime and high-cost loans

---

38. Purchases refer to secondary market activity involving banks buying loans from other banks, mortgage companies, and other types of lenders. Loan originations refer to loans made directly by a bank.

39. *See* Community Reinvestment Act Regulations, 69 Fed. Reg. 5729, 5732 (Feb. 6, 2004) (to be codified at 12 C.F.R. pts. 25, 228, 345, 563e).

40. 12 C.F.R. § 203.4 (2008).

offer a balanced product mix to LMI borrowers and communities. This objective can be achieved only if prime and high-cost lending are analyzed separately.

While a significant issue with HMDA data has been its application on CRA exams, the predominant issue regarding small business data is quality. By exempting intermediate small banks from requirements to collect and report this data, the federal agencies effectively lowered the bar on the quality of the CRA small business lending data. As NCRC demonstrated in its report for the Appalachian Regional Commission, intermediate small banks are an important source of credit for small businesses, particularly in rural areas and medium-sized cities and towns. The agencies' decision to exempt the intermediate small banks from the reporting requirement negatively affects the CRA's ability to ensure that banks consistently respond to credit needs, including those of small businesses.

Limited information available on the demographics of small business borrowers hinders an accurate assessment of banks' responsiveness to credit needs. Periodic national surveys sponsored by the Federal Reserve Board consistently point towards the probability of discrimination playing a part in small business lending.<sup>41</sup> A powerful way to stop such discrimination and disparities in lending is to publicly provide data on the number of loans for minorities and women. Yet, the CRA small business data does not specify the gender or race of the small business owner.<sup>42</sup>

Rep. James McGovern (D-Mass.) introduced the Access and Openness in Small Business Lending Act of 2003 (H.R. 1748), which requires reporting the race and gender of the small business owner and mandates additional demographic detail in the CRA small business data.<sup>43</sup> Congress should pass this bill and should either pass another bill or urge the regulatory agencies to reverse their decision exempting intermediate small banks from the CRA small business data reporting requirements.

### III. HOW TO IMPROVE CRA RATINGS

Ratings on CRA exams are a critical element of the CRA process and also figure prominently in the merger application process. A bank's public reputation can be affected by positive or negative ratings. These ratings should be awarded carefully, and examiners should resist inflating banks' ratings.

#### *CRA Grade Inflation*

As the table below shows, the current failure rate for banks has hovered between 1 to 2% in recent years (ratings of "Needs to improve" or "Substantial non-compliance" indicate a bank has failed its CRA exam). When ratings first became publicly

---

41. See NAT'L CMTY. REINVESTMENT COAL., ACCESS TO CAPITAL AND CREDIT FOR SMALL BUSINESSES IN APPALACHIA, *supra* note 35, at 61–63.

42. It also lacks detail on the annual revenue of small businesses and has other limitations, such as not separately reporting originations from renewals of loans.

43. H.R. 1748, 108th Cong. (2003).

available in 1990, more than 10% of banks failed their CRA exams.<sup>44</sup> During the first five years of the public availability of CRA ratings, more than 5% of banks failed their CRA exams each year.

Year	Outstanding		Satisfactory		Needs to Improve		Substantial Noncompliance		Total
	Count	Percent	Count	Percent	Count	Percent	Count	Percent	
1990	340	10.9%	2,474	79.5%	280	9.0%	19	0.6%	3,113
1991	407	8.3%	4,016	81.6%	453	9.2%	46	0.9%	4,922
1992	653	12.7%	4,067	78.9%	395	7.7%	40	0.8%	5,155
1993	941	14.7%	5,060	79.3%	355	5.6%	26	0.4%	6,382
1994	1,000	18.1%	4,249	76.7%	275	5.0%	15	0.3%	5,539
1995	1,363	24.3%	4,106	73.1%	138	2.5%	7	0.1%	5,614
1996	1,214	26.5%	3,275	71.5%	81	1.8%	11	0.2%	4,581
1997	829	22.4%	2,807	75.7%	59	1.6%	11	0.3%	3,706
1998	681	18.6%	2,915	79.6%	59	1.6%	7	0.2%	3,662
1999	679	18.6%	2,915	79.7%	55	1.5%	7	0.2%	3,656
2000	220	17.5%	1,001	79.6%	30	2.4%	7	0.6%	1,258
2001	132	10.6%	1,088	87.1%	23	1.8%	6	0.5%	1,249
2002	201	9.8%	1,820	89.0%	18	0.9%	5	0.2%	2,044
2003	283	10.1%	2,492	89.2%	17	0.6%	3	0.1%	2,795
2004	329	13.1%	2,170	86.1%	17	0.7%	3	0.1%	2,519
2005	244	15.9%	1,278	83.2%	10	0.7%	4	0.3%	1,536
2006	171	13.1%	1,109	84.9%	20	1.5%	6	0.5%	1,306
2007	154	10.5%	1,292	87.8%	20	1.4%	4	0.3%	1,470
<b>Total</b>	<b>9,841</b>	<b>16.3%</b>	<b>48,1374</b>	<b>79.5%</b>	<b>2,305</b>	<b>3.8%</b>	<b>227</b>	<b>0.4%</b>	<b>60,507</b>

Undoubtedly, banks improved their CRA performance over the years as they bolstered their efforts to make loans, investments, and services in LMI communities. However, it is implausible that a full 98% of banks have satisfied their CRA responsibilities. As discussed above, the Center for Community Capitalism found ratings inflation in the CRA service tests. In addition, Rick Marsico in his book

44. See Federal Financial Institutions Examination Council, <http://www.ffiec.gov/craratings/default.aspx> (last visited Oct. 27, 2008).

*Democratizing Capital* reveals how quantitative criteria are applied inconsistently on CRA exams, suggesting that a number of ratings cannot be justified.<sup>45</sup>

The CRA Modernization Act contains a number of provisions that would be helpful for preventing grade inflation. The first is introducing more refined ratings. Currently, the CRA component tests (such as the Lending Test) have “Outstanding,” “High Satisfactory,” “Low Satisfactory,” “Needs to improve,” and “Substantial non-compliance” as possible grades. In contrast, the final rating on a CRA exam can be one of only four grades: “Outstanding,” “Satisfactory,” “Needs to improve,” and “Substantial non-compliance.” High and Low Satisfactory grades should be added to the overall CRA ratings system so as to allow the general public and the federal agencies to better assess actual differences and gradations in performance.

If a low CRA rating in an assessment area triggered requirements for a bank to improve its performance, a bank would be more likely to adequately serve all geographical areas, including smaller cities and rural areas in addition to large cities. Currently, low CRA ratings even on a state level rarely have concrete ramifications for banks. The CRA Modernization Act of 2007 would require federal agency enforcement to correct low ratings and would require public input in this process. If a bank receives a rating of “Low satisfactory” or worse in any assessment area, the Modernization Act would require it to submit a CRA improvement plan to its regulatory agency, describing how it intends to bolster its CRA performance in that assessment area.<sup>46</sup> The general public would then have an opportunity to comment on the CRA improvement plan. The regulatory agency would either approve the CRA improvement plan or send it back to the bank for modifications. After the agency approved the CRA improvement plan, a bank would be required to submit quarterly reports so that the regulatory agency and general public could monitor performance under the terms of the plan.

## **V. BOLSTERING THE MERGER APPLICATION PROCESS AND PUBLIC PARTICIPATION**

The merger application process presents significant opportunities for federal agencies to enforce the CRA. Yet the enforcement of community reinvestment obligations through the merger application process has been lacking over the last several years. In spite of the problematic lending of the last several years, the agencies have refrained from mandating improvements in CRA and fair lending performance when considering merger applications. Also, the agencies have been reluctant to involve the public in a substantive manner through public hearings and meetings.

---

45. See RICHARD D. MARSICO, *DEMOCRATIZING CAPITAL: THE HISTORY, LAW, AND REFORM OF THE COMMUNITY REINVESTMENT ACT* (2005).

46. The concept of an improvement plan builds upon a procedure mandated by the current CRA regulation. Section 345.43 of the FDIC’s version of the regulation states that a bank with a lower than “Satisfactory” rating shall allow the public to inspect a description of its efforts to “improve its performance in helping to meet the credit needs of its entire community.” This description is to be updated quarterly. 12 C.F.R. § 345.43 (2008).

In congressional testimony in 2007, a Federal Reserve Board (“FRB”) representative testified that the FRB has held only thirteen public meetings since 1990 on mergers. This is less than one meeting per year in an era in which consolidations have profoundly changed the banking industry. In addition, the FRB official stated that since 1988, the FRB received 13,500 applications for the formation of banks or the merger of institutions involving bank holding companies or state-chartered banks that were members of the Federal Reserve System. Yet, only twenty-five of these applications were denied, with eight of these denials involving consumer protection or community needs issues.<sup>47</sup>

Based on the record of merger reviews described by the Federal Reserve testimony to Congress, it is unlikely that mergers will be denied in the future. However, the agencies can influence the outcome of merger applications in other ways. Conditional approvals have been issued in the past, requiring banks to institute non-discriminatory and anti-predatory lending safeguards. In addition, public hearings and meetings held by the regulatory agencies often facilitate mutually acceptable solutions to deficiencies in bank performance. Sometimes a bank will make a CRA agreement with a community group as described above. In other instances, a bank will pledge to implement a new lending program or best practice that responds to a community concern expressed at the hearing. Regulatory agencies may also require or encourage a specific reform after careful consideration of community input. As the Federal Reserve official indicated in testimony, however, public hearings are rare.<sup>48</sup> Conditional merger approvals have become almost non-existent in recent years.

The last major merger applications that were subject to public hearings were the Bank of America and Fleet merger and J.P. Morgan Chase and Bank One mergers in 2004. In 2006, Wachovia acquired the largest lender of exotic mortgages, World Savings, yet there was no public hearing on this merger that posed significant fair lending and safety and soundness issues. Likewise, Regions had proposed to take over AmSouth Bank in 2006. Although this merger involved two of the larger banks in the South, the Federal Reserve declined to hold a public hearing in spite of the clear ramifications for the recovery of the Gulf States after Hurricane Katrina. More recently, the Federal Reserve declined to hold a hearing on the merger of Bank of New York and Mellon although the Bank of New York had received low ratings on two of the three tests on their two most recent CRA exams.<sup>49</sup>

---

47. See *Bank Mergers, Community Reinvestment Act Enforcement, Subprime Mortgage Lending, and Foreclosures: Hearing Before the Subcomm. on Domestic Policy of the H. Comm. on Oversight and Government Reform*, 110th Cong. (2007) (testimony of Sandra Braunstein, Director, Federal Reserve Board Division of Consumer and Community Affairs), available at <http://www.federalreserve.gov/newsevents/testimony/braunstein20070521a.htm>.

48. *Id.*

49. Fed. Res. Bank of N.Y., CRA Performance Evaluation of The Bank of N.Y. 3 (May 16, 2005) (giving a “low satisfactory” rating on lending and service tests); and Fed. Res. Bank of N.Y., CRA Performance Evaluation of The Bank of N.Y. 3 (May 19, 2003) (giving a “low satisfactory” rating on lending and service tests). In other words, the bank was close to failing on two CRA exams in succession. Yet, no public hearing on the merger occurred.

The Office of Thrift Supervision (“OTS”) used to require that a meeting be held between merging thrifts and community groups when such a meeting was requested by a community group that had submitted written comments pertaining to the merger.<sup>50</sup> This procedure should be implemented by all the agencies. Meetings, as distinguished from public hearings, usually involve a relatively small number of stakeholders that may include regulatory officials, community leaders, and representatives of the merging institutions. These meetings provide valuable dialogue.

When regulatory agencies receive several requests from community groups or citizens for a public forum, they should hold public hearings in addition to any meetings that might take place. Public hearings are more complex than meetings in that several community groups, citizens, elected officials, and others offer testimony at the public hearings. Meetings allow for in-depth dialogue and debate among a handful of important stakeholders, but public hearings become necessary when hundreds of citizens and community organizations wish to testify. Regulatory officials must afford them the opportunity to testify and to explain to officials the gravity of a situation and the importance of a bank to the affected communities.

Finally, the CRA Modernization Act of 2007 has a provision stopping a merger proceeding if a bank has a failed rating in any assessment area.<sup>51</sup> If a bank receives a rating of “Needs to improve” or “Substantial non-compliance” in any assessment area, its regulatory agency cannot accept or approve any merger application submitted by that bank until a subsequent CRA exam issues that bank a better rating. This provision assures that a bank must have passing grades and reasonable CRA performance in all assessment areas, including smaller cities and rural areas, in addition to larger cities. Also, the CRA Modernization Act stipulates that if a bank receives “Low Satisfactory” in an assessment area, its regulatory agency must consider progress made in meeting the goals described in the improvement plan as an integral factor when reviewing a merger application.

## **VI. THE ADEQUACY OF FEDERAL AGENCY ANTI-DISCRIMINATION REVIEWS ON CRA EXAMS**

Evidence of discriminatory and illegal lending can result in downgrades of CRA ratings for banks if discrimination and illegal lending were widespread and the lender did not take action to end the practices. There is little evidence that the fair lending reviews conducted concurrently with CRA exams are rigorously testing for abusive, discriminatory, and illegal lending.

In most cases, even for the largest banks in the country, the fair lending section of the CRA exam reports in a cursory manner that the regulatory agency tested for

---

50. The OTS deleted the meeting requirement in their effort to streamline regulations for savings and loans. In this instance, the streamlining was counterproductive since meetings are not burdensome and facilitate solutions beneficial to the financial institution and communities impacted by mergers.

51. Community Reinvestment Modernization Act of 2007, H.R. Res. 1289, 110th Cong. § 105(c)(3)(E)(v) (2007).

evidence of illegal and discriminatory lending and that no such lending was found.<sup>52</sup> There is no detailed discussion of the types of analyses conducted to test for discrimination.

In one instance, NCRC examined a thrift that specialized in subprime lending. The CRA exam report for that thrift noted that it issued a high percentage of loans to LMI borrowers. The CRA fair lending review, however, did not describe whether or not the examiner had made any efforts to determine if the subprime lending was conducted in a non-discriminatory manner or was consistent with safety and soundness.<sup>53</sup> In another case, an exam mentioned that a bank specialized in adjustable rate lending, but the fair lending review did not mention whether the examiner assessed if the loans were offered in a non-discriminatory manner and whether they were safe and sound.<sup>54</sup>

More detailed descriptions of fair lending reviews are necessary. The agencies used to provide detailed descriptions in the fair lending section of CRA exams in the mid-1990s under the previous “assessment factor” format of CRA exams. For example, in a CRA exam dated January 1996, under Assessment Factor F, which assessed evidence of discriminatory or illegal practices, the Federal Reserve Bank of Richmond conducted matched file reviews of more than 300 loan applications made to Signet Bank. The exam also described a regression analysis, which sought to determine whether race was a factor in loan rejections. The analysis considered variables not available in the HMDA data such as credit histories, the stability of employment, and applicant debt obligations. This type of substantive fair lending review provides the general public with confidence that the regulatory agency performed a detailed anti-discrimination analysis. It was after the CRA regulations were reformed during the mid-1990s that these descriptions of fair lending reviews disappeared. As discussed above in the section about analyzing lending to minorities, the agencies streamlined certain aspects of CRA exams. In this case, the streamlining was counterproductive.<sup>55</sup>

When a violation of anti-discrimination laws is discovered through fair lending reviews, it is common for the federal agencies to make a bank promise to eliminate the practice instead of lowering a CRA rating. The CRA regulation specifies that examiners are to weigh the evidence and extent of a discriminatory and illegal practice when deciding whether to lower a CRA rating.<sup>56</sup>

---

52. For example, a federal agency had only this to say on the CRA exam’s fair lending review of one large bank with several affiliates, a number of which make high cost loans: “We found no evidence of illegal discrimination or other illegal credit practices.” That was the only sentence in the fair lending review section.

53. See Office of Thrift Supervision, *supra* note 24.

54. See Fed. Deposit Ins. Corp., CRA Performance Evaluation of Franklin Bank, S.S.B., Cert. # 26870 (Jan. 4, 2005) (on file with author).

55. The changes in the mid-1990’s may appear to contradict the 1996 Signet Bank exam. The agencies’ changes usually take a few years to implement, meaning that the Signet exam was conducted under the previous exam structure.

56. See 12 C.F.R. § 345.28 (2008).

Some discretion in requiring corrective actions or lowering ratings is appropriate, but guidelines should specify when discrimination will lower ratings. Isolated instances of discrimination can be corrected through promised reforms. On the other hand, widespread discrimination should result in failed ratings. Discriminatory underwriting, including prohibiting loans to row homes, redlines entire communities. It is ineffective and insufficient to rely on the banks' promises to reform. A failed CRA rating provides a significant deterrent against discriminatory behavior because a failed CRA rating prevents a bank holding company from acquiring a non-depository financial institution as long as the rating remains in place.<sup>57</sup> The failed rating can be removed after better results at the bank's next CRA exam, provided that the bank undergo a thorough fair lending review, and can demonstrate that it has eradicated all discriminatory practices.

#### VII. FREQUENCY OF CRA EXAMS FOR SMALL BANKS

As discussed above, the Gramm-Leach-Bliley Act ("GLBA") reduced the frequency of small bank CRA exams. Under the GLBA, small banks with assets of under \$250 million are examined only once every four years if they have a "Satisfactory" CRA rating and once every five years if they have an "Outstanding" rating.<sup>58</sup>

When small banks are examined that infrequently, they have little incentive to affirmatively and continually adhere to their reinvestment obligations. They will have reduced incentives to make sufficient numbers of loans to LMI borrowers during the entire four- or five-year time period between exams, and may only focus their efforts during the last year or two before exams. It is common sense that infrequent examinations lead to infrequent commitments to reinvestment, while more frequent examinations lead to more consistent commitments to reinvestment.

This reduction in exam frequency was made in response to industry concerns about the "burden" of CRA exams. The lack of a careful cost-benefit analysis is readily apparent in the GLBA stretch-out of the small bank CRA exam schedule. The small bank exam is a quick and straightforward exam that focuses on lending and dispenses with the investment and service test of the large bank exam.

Despite the brevity of the exam, its importance cannot be underestimated. In too many poor rural communities, the CRA exam process is the only mechanism that holds small banks accountable for serving LMI borrowers and communities. Smaller banks do not merge nearly as often as their larger counterparts, rendering the merger application process a seldom-used avenue for holding smaller banks accountable. Community groups are also not as prevalent in smaller rural communities as in large cities. Thus, the major mechanism for holding small banks accountable is the CRA exam.

---

57. Gramm-Leach-Bliley Financial Modernization Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999) (instituting the "have and maintain" passing rating requirement).

58. *Id.*

In their analysis on small bank burdens, the federal banking agencies have found that CRA regulations “impose a modest information collection burden on small institutions—an average of 10 burden hours per institution per year.”<sup>59</sup> In addition, the relatively few trade articles on small bank CRA exams also reveal few complaints about their burden. In fact, an *American Banker* article shortly after the CRA regulation reform in 1995, titled “Small Banks Give Thumbs-Up to Streamlined CRA Exams,” quotes small bankers as saying that the exams were not burdensome and that the CRA examiners took less than one day of their time.<sup>60</sup>

### VIII. THE NEED TO EXTEND CRA TO NON-BANK FINANCIAL INSTITUTIONS

In the thirty years since the CRA’s enactment, the financial industry has changed in profound ways. Banks now face more formidable competitors, including independent mortgage companies and large credit unions, than they did in 1977. These competitors are not now covered by the CRA. As long as these lenders remain uncovered, it is likely that their lending will be less safe and sound than the banks’ or that they will offer a smaller portion of loans to LMI communities than banks do. Above, we describe how credit unions and independent mortgage companies do not offer as large a percentage of home loans to LMI borrowers as banks. NCRC’s fair lending investigation discussed above revealed that twenty-six of the thirty-five institutions engaged in redlining and other discriminatory practices were independent mortgage companies not covered by the CRA.<sup>61</sup>

Congress should look to the example of the state of Massachusetts. Massachusetts has required credit unions to comply with the CRA. The state has also recently enacted a community reinvestment requirement for mortgage companies.<sup>62</sup> The CRA Modernization Act of 2007 would likewise require the application of the CRA to independent mortgage companies.<sup>63</sup>

The CRA Modernization Act of 2007 would also require the application of the CRA to insurance companies and would impose HMDA-like data disclosure requirements on insurance companies. A number of states already collect data on insurance provisions and provide this data to the general public.<sup>64</sup> After the denials of insurance for victims of Hurricane Katrina, the time has come to shine a public

---

59. Notice, 64 Fed. Reg. 29,083 (May 28, 1999).

60. Jaret Seiberg, *Small Banks Give Thumbs-Up to Streamlined CRA Exams*, AM. BANKER, Feb. 1, 1996, at 4.

61. *Id.*

62. H. 4387, 185th Gen. Ct., Reg. Sess. (Mass. 2007).

63. Community Reinvestment Modernization Act of 2007, H.R. Res. 1289, 110th Cong. (2007).

64. See Gregory D. Squires, Sally O’Connor & Josh Silver, *The Unavailability of Information on Insurance Unavailability: Insurance Redlining and the Absence of Geocoded Disclosure Data* 12 HOUSING POL’Y DEBATE, 347, 352 (2001) (finding that eight states require property insurers to provide at least some geocoded data to the state, and of those states, four make the data available to the public).

spotlight on the practices of insurance companies and the distribution of their policies based on certain characteristics of consumers and communities.<sup>65</sup>

Finally, the CRA Modernization Act of 2007 would require the application of the CRA to securities firms. CRA exams would measure the extent to which securities firms are serving LMI and minority consumers. Wealth-building would be augmented considerably if more people of modest means and more minorities had access to mutual funds and other similar products. In addition, if a law channeled more security firm investments into minority and working class neighborhoods, the economic development prospects of these communities would be significantly enhanced.

### CONCLUSION

In light of the present day lending crisis and its disparate impact on minority and low- and moderate-income communities, the CRA must be modernized and enhanced to apply to non-bank financial institutions. The CRA has been effective in bringing about \$5 trillion of loans, investments, and services in CRA agreements to LMI communities. Yet, too many LMI and minority communities still remain left out of the financial mainstream under the current construct. For America to truly become a financially inclusive society, the federal agencies' application of the CRA to banks needs strengthening, and the CRA must also be applied to non-bank financial institutions.

The CRA has great potential to act as an antidote to the foreclosure crisis by requiring all financial institutions to safely and soundly serve minority and LMI communities.

As described in detail above, the following steps must be taken to bolster CRA's effectiveness in increasing access to credit and capital for minorities and low- and moderate-income communities.

1. Extend the CRA to cover non-depository institutions, including:
  - Credit Unions
  - Securities Companies
  - Mortgage Companies
  - Insurance Firms
  - Investment Banks
2. Agency Oversight:
  - The CRA's scrutiny of illegal and predatory lending practices must become more transparent and rigorous. Evidence of widespread discriminatory practices must result in downgrades in CRA ratings.
  - The agencies must hold more public hearings on merger applications and issue more conditional merger approvals.

---

65. See, e.g., Joseph B. Treaster, *Small Clause, Big Problem*, N.Y. TIMES, Aug. 4, 2006, at C1.

- Low scores for any assessment area must trigger regulatory enforcement, including the submission of improvement plans and heightened attention during the merger application process.
  - The stretch-out of the small bank CRA exam cycle should be eliminated. Small banks should be examined as frequently as large banks.
3. Reform CRA assessment areas and affiliate procedures:
    - Assessment area procedures must be reformed so that a great majority of a bank's loans are on CRA exams.
    - All non-depository affiliates of banks must be included on CRA exams.
  4. Refinement of CRA examination criteria:
    - CRA exams must explicitly consider lending, investments, and services to minority borrowers and communities.
    - Federal agencies must enhance the rigor of the service test and increase data collection of bank deposit accounts, at least by income level of neighborhood.
    - The community development test of mid-size banks must do a better job assessing the provision of bank branches and services in LMI neighborhoods.
    - CRA exams must separately consider purchases and loan originations.
    - CRA exams must also separately consider prime and high-cost lending.
    - The quality of CRA small business data needs to be enhanced through the disclosure of the race and gender of the small business owner.
    - CRA grade inflation needs to be counteracted by increasing the number of possible ratings.