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FIGHTING POVERTY THROUGH COMMUNITY EMPOWERMENT AND ECONOMIC DEVELOPMENT: THE ROLE OF THE COMMUNITY REINVESTMENT AND HOME MORTGAGE DISCLOSURE ACTS

*Richard D. Marsico**

I. Introduction

The traditional government social welfare programs aimed at poverty may alleviate some of poverty's harshest consequences for needy individuals, but they are not designed to eliminate poverty.¹ On the other hand, two unique federal statutes, the Community Reinvestment Act ("CRA")² and the Home Mortgage Disclosure Act ("HMDA"),³ provide opportunities to eliminate poverty through community empowerment and economic development.

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¹ See Erwin Chemerinsky, *The Fire This Time*, 66 S. CAL. L. REV. 1571, 1579 (1993) (noting that most government programs are aimed at the symptoms of poverty and are not cures for it).

² 12 U.S.C. §§ 2901-2905 (1994).

³ 12 U.S.C. §§ 2801-2810 (1994).

Community groups have used the CRA and HMDA to force banks into loaning billions of dollars to low-income neighborhoods.⁴ However, due to several factors, including underenforcement of the laws,⁵ their own internal limitations, and the dependency they foster on outside institutions, the full potential of the CRA and HMDA poverty-fighting tools has not been realized.

Increasingly, however, community groups have been employing a strategy with more potential. They have been using the CRA and HMDA to support and create community development financial institutions ("CDFIs"), which are community-controlled financial intermediaries explicitly designed to eliminate poverty and meet community credit needs.⁶ Using the CRA and HMDA to support CDFIs promises to fight poverty more effectively. CDFIs bypass the underenforcement and internal limitations of the CRA and HMDA. They also help to develop low-income communities' economic infrastructure and reduce dependency on outside institutions.⁷

⁴ See Maron A. Cowell, Jr. & Monty D. Hagler, *The Community Reinvestment Act in the Decade of Bank Consolidation*, 27 WAKE FOREST L. REV. 83, 83 (1992).

⁵ See, e.g., Robert C. Art, *Social Responsibility in Bank Credit Decisions: The Community Reinvestment Act One Decade Later*, 18 PAC. L.J. 1071, 1106-07 (1987) (characterizing agency enforcement as "low priority"); Allen J. Fishbein, *The Community Reinvestment Act after Fifteen Years: It Works, But Strengthened Federal Enforcement Is Needed*, 20 FORDHAM URB. L.J. 293, 296 (1993) (identifying the inadequacies of CRA enforcement); Stephen A. Fuchs, *Discriminatory Lending Practices: Recent Developments, Causes and Solutions*, 10 ANN. REV. BANKING L. 461, 479-80 (1991) (noting the lack of enforcement of federal laws by federal agencies and characterizing the CRA as "a monument to regulatory inaction").

⁶ See discussion *infra* part III.A.

⁷ Anthony D. Taibi, *Banking, Finance, and Community Economic Empowerment: Structural Economic Theory, Procedural Civil Rights, and Substantive Racial Justice*, 107 HARV. L. REV. 1463, 1469 (1994) ("Working-class, ethnic, and minority communities must control their own destinies by wresting control of local finance away from non-local institutions; they must not simply ask those institutions to invest a little more in local neighborhoods.").

A. Statutory Overview

The CRA requires the federal bank regulatory agencies⁸ (the “agencies”) to encourage insured depository institutions (“banks”) to meet the credit needs of low- and moderate-income communities.⁹ It requires a bank’s federal regulatory agency to periodically assess a bank’s community lending record and to take that record into account when considering a bank’s application to expand its business.¹⁰ Community residents can enforce this community lending obligation by filing a challenge to a bank’s application with the bank’s supervisory agency on the grounds that the bank has failed to meet community credit needs.¹¹ The regulator can deny the application if the bank’s CRA record is inadequate.

The HMDA requires banks to disclose information about their home mortgage lending record, including the disposition of home mortgage applications according to the race, gender, and income of

⁸ There are four federal banking agencies: the Office of the Comptroller of the Currency (“OCC”), the Board of Governors of the Federal Reserve System (the “Federal Reserve”), the Federal Deposit Insurance Corporation (“FDIC”), and the Office of Thrift Supervision (“OTS”). See 12 U.S.C. § 2902(1) (1994).

⁹ See Statement of the Federal Financial Supervisory Agencies Regarding the Community Reinvestment Act, 54 Fed. Reg. 13,742, 13,743 (1989); 12 U.S.C. §§ 2901(a)-(b), 2903(1) (1994).

¹⁰ 12 U.S.C. §§ 2902-2903 (1994). Each agency has promulgated nearly identical substantive CRA regulations. See 12 C.F.R. § 25 (1994) (OCC); 12 C.F.R. § 228 (1994) (Federal Reserve); 12 C.F.R. § 345 (1994) (FDIC); and 12 C.F.R. § 563(e) (1994) (OTS). The agencies have also issued several joint CRA policy statements. See Community Reinvestment Act Interagency Questions and Answers, 58 Fed. Reg. 9176 (1993) [hereinafter CRA Q and A]; Uniform Interagency Community Reinvestment Act Final Guidelines for the Disclosure of Written Evaluations and Revised Assessment Rating System, 55 Fed. Reg. 18,163 (1990) [hereinafter Uniform Interagency Guidelines]; Statement of the Federal Financial Supervisory Agencies Regarding the Community Reinvestment Act, 54 Fed. Reg. 13,742, 13,743 (1989) [hereinafter CRA Statement]. Effective July 1, 1997, the regulations and policy statements will be replaced by new regulations. See 60 Fed. Reg. 22,156 (1995).

¹¹ For more about the CRA, see generally GREGORY D. SQUIRES ET AL., FROM REDLINING TO REINVESTMENT (1992); Art, *supra* note 5; Richard Marsico, *A Guide to Enforcing the Community Reinvestment Act*, 20 FORDHAM URB. L.J. 165 (1993); Daniel D. Pearlman & Roger L. Q. Nguyen, *The Community Reinvestment Act: 15 Years Later*, 21 HOUS. L. BULL. 117 (1991); Fred R. Bleakley, *How Groups Pressured One Bank To Promise More Inner-City Loans*, WALL ST. J., Sept. 22, 1992, at 1.

the applicant and the location of the property.¹² These data are frequently used to challenge bank expansion applications.

*B. Limits of the "Traditional" Approach
to CRA Enforcement*

Community groups from low-income communities have traditionally used the CRA and HMDA to challenge bank merger applications on the grounds that the particular bank has not met community credit needs and then negotiate lending agreements with the bank. Although this "traditional" approach has resulted in funneling billions of dollars of loans into low-income communities, it has several disadvantages as a poverty-fighting strategy. First, the CRA and HMDA have limits. Neither the CRA nor HMDA establish loan quotas for low-income neighborhoods or require a bank to meet all community credit needs, especially those of the neediest residents. Second, the agencies that enforce the CRA and HMDA have interpreted them more restrictively than either their language or their legislative histories indicate is necessary.¹³ Third, in relying on banks and other institutions outside the control of low-income communities, the traditional approach does not do enough to develop the community's economic infrastructure. Thus, the traditional approach does not maximize the potential of the CRA and HMDA as tools to fight poverty.

*C. The Potential of Community Development
Financial Institutions*

In contrast to the traditional approach, community groups can use—and increasingly are using—the CRA and HMDA to promote community empowerment and economic development, and to fight poverty on a deeper, more permanent level. Community groups are

¹² 12 U.S.C. § 2803(b)(4) (1994).

¹³ The federal bank regulatory agencies have adopted a new set of regulations. See 60 Fed. Reg. 22,156 (1995) (to be codified at 12 C.F.R. §§ 25, 228, 345, and 563e). The new regulations will become effective on July 1, 1997. See 12 C.F.R. § 25.51. Although these new regulations are designed to make CRA enforcement more consistent, predictable, and substantive, it is unclear whether they will result in stricter CRA enforcement.

using the CRA and HMDA to create and support CDFIs dedicated to meeting community credit needs. CDFIs include community-based loan counseling programs, community development loan funds, micro-enterprise loan funds, community development credit unions, and community development banks.¹⁴

Using the CRA and HMDA to create CDFIs has several advantages. First, the CDFI approach does not require legislative or regulatory change because the CRA, as presently construed, encourages banks to assist community efforts to create CDFIs.¹⁵ Second, in August 1994, Congress passed legislation appropriating \$382 million to support CDFIs.¹⁶ Third, after years of neglecting to strictly enforce the CRA obligations of foreign-owned and domestic "wholesale" banks, the federal banking agencies are putting more pressure on them to improve their CRA records.¹⁷ Many of these banks are doing so by making loans to and investments in CDFIs or similar entities.¹⁸ Fourth, CDFIs are supported by individuals representing a wide spectrum of views.¹⁹ Finally, in helping to develop a community-based economic infrastructure and promoting community self-determination rather than dependence on banks and other outside institutions, CDFIs offer a much more promising means

¹⁴ Rochelle E. Leito, *Community Development Banking Strategy for Revitalizing Our Communities*, 27 U. MICH. J.L. REF. 773, 776 (1995).

¹⁵ See *infra* text accompanying notes 54-56. Although the proposed CRA regulations might not make overall CRA enforcement more strict, the proposed CRA regulations would make agency support for bank participation in CDFI activities even more explicit. See *infra* text accompanying notes 138-40.

¹⁶ The Community Development Banking and Financial Institutions Act of 1994, 12 U.S.C. §§ 4701-4718 (1994); Robert M. Garson, *Industry Wins Big as Senate Approves Lending Bill*, AM. BANKER, Aug. 11, 1994, at 1.

¹⁷ Wholesale banks have few or no branches and generally serve only large corporate customers and wealthy individuals.

¹⁸ See Christine Dugas, *Unrest Moves City's Bankers*, NEWSDAY, May 6, 1992, at 45; Robert McNatt, *Housing Group Bonds with Japan Banks*, CRAIN'S N.Y. BUS., May 11, 1992, at 24; Michael Quint, *Housing Plan in New York Taps Banks from Abroad*, N.Y. TIMES, May 6, 1991, at B1; Paul H. Scheiber, *A CRA Guide for Foreign Banks*, AM. BANKER, Feb. 14, 1991, at 14.

¹⁹ See Jonathan R. Macey & Geoffrey P. Miller, *The Community Reinvestment Act: An Economic Analysis*, 79 VA. L. REV. 291, 344-47 (1993); Peter Swire, *Safe Harbors and a Proposal to Improve the Community Reinvestment Act*, 79 VA. L. REV. 349, 356-57, 363 (1993); Taibi, *supra* note 7; Anthony D. Taibi, *Race Consciousness, Communitarianism, and Banking Regulation*, 1992 U. ILL. L. REV. 1103, 1105 (1992).

for communities to end poverty than do loans from traditional banks.²⁰

Part II of this article will examine both the potential and limits of using the CRA and HMDA to fight poverty through community empowerment and economic development. Part III will show how the CRA and HMDA can be used to support the creation and growth of CDFIs. Part III will also show how CDFIs, in helping to build a community economic infrastructure and to promote community economic development, are more effective than banks could ever be in eliminating poverty.²¹

II. The Limits of Using the CRA and HMDA To Fight Poverty

In passing the CRA and HMDA, Congress hoped to increase the level of lending in low-income neighborhoods and to strengthen communities.²² However, Congress stopped short of mandatory lending provisions, leaving to the federal banking regulatory agencies the task of determining how to increase their lending without imposing lending quotas. The agencies, however, have

²⁰ See Taibi, *supra* note 7, at 1522 ("In addition, CDFI lending programs encourage entrepreneurship, self-sufficiency, and creative problem solving—essential qualities for national and community economic prosperity, and for breaking the cycles of poverty and welfare dependency.").

²¹ Three potential critiques of the CDFI approach are that it would allow banks to forego their obligations to lend directly to the community, that so much money is necessary to finance the needs of low-income communities that CDFIs cannot possibly meet the needs without assistance from banks, and that using the CRA and HMDA to support CDFIs promotes dependency in the same way as direct lending. This article, however, does not suggest that community groups should stop using the CRA to pressure banks to make more loans to low-income communities or that ending poverty is the sole function of the CRA. Rather, it suggests that the CDFI approach promises to be a more effective way to eliminate poverty than traditional bank lending and should continue to grow as an important part of community group CRA strategies. Regarding dependency, CDFIs determine how and where to invest their money and on what terms it will be loaned. While they may rely for some of their investment capital on banks, CDFIs maintain control over its disposition.

²² 12 U.S.C. §§ 2801(b), 2901(a)-(b), 2903(1) (1994); CRA Statement at 13,743 (1989).

underenforced the CRA and HMDA, further undermining their effectiveness.²³

A. *Increasing Lending in Low-Income Areas*

1. *Congressional Intent*

It is difficult to determine Congress' intent in passing the CRA. The CRA is a vague statute which does not proscribe or prescribe particular behavior, but only requires that regulators exhort banks to do more lending in low-income areas. There is also an internal tension in the CRA, which on the one hand seeks to increase loans in low-income areas but, on the other hand, prohibits the allocation of credit to particular areas. Nevertheless, it is possible to identify the goals Congress sought to accomplish through the CRA, and these goals can provide some guidance as to CRA's enforcement.

Congress passed the CRA and HMDA in light of evidence that banks had redlined inner city neighborhoods, contributing to their decay and destabilization.²⁴ The HMDA's statement of findings states that "some depository institutions have sometimes contributed to the decline of certain geographic areas by their failure . . . to . . . provide adequate home financing to qualified applicants on reasonable terms and conditions."²⁵ Congress hoped that passage of the CRA and HMDA would help eliminate such redlining.²⁶

²³ See sources cited *supra* note 5 and accompanying text.

²⁴ H.R. REP. NO. 175, 95th Cong., 1st Sess. 33 (1977); 121 CONG. REC. 25,159, 25,162, 27,622, 34,569, 34,576 (1975); H.R. REP. NO. 561, 94th Cong., 1st Sess. 12, 20 (1975); H.R. REP. NO. 187, 94th Cong., 1st Sess. 1, 3, 4, 10 (1975). "Redlining" is refusing to lend, or lending at significantly higher rates, in certain areas due to inappropriate criteria such as race. See BLACK'S LAW DICTIONARY 1279 (6th ed. 1990); Michael S. Little, *A Citizen's Guide to Attacking Mortgage Discrimination: The Lack of Judicial Relief*, 15 B.C. THIRD WORLD L.J. 323, 325 (1995).

²⁵ 12 U.S.C. § 2801(a) (1994).

²⁶ 123 CONG. REC. 17,604 (1977); President's Remarks on Signing Into Law, Housing and Community Development Act of 1977, 13 WEEKLY COMP. PRES. DOC. 1777 (Oct. 12, 1977).

Congress hoped that the CRA and HMDA would likewise help ensure an adequate supply of credit to inner city neighborhoods.²⁷ The CRA's statement of purpose states that banks "have a continuing and affirmative obligation to help meet the credit needs of the local communities in which they are chartered."²⁸ As CRA-sponsor Senator Proxmire pointed out, banks are chartered to meet the convenience and needs of their communities, and "convenience and needs does not just mean drive-in teller windows and Christmas Club accounts. It means loans."²⁹ The CRA was to "provide as much incentive as [Congress] could for local investment in local communities."³⁰

Congress also hoped that the CRA would strengthen public economic development efforts. Congress recognized a "vital interconnection between successful community and housing development and local private investment activities."³¹ Private loans were a necessary part of public reinvestment efforts³² and essential in ensuring continued public investment.³³ Congress included the CRA as part of the Housing and Community Development Act of 1977 in order to encourage participation in the Act's federal grant and insurance programs to help rebuild inner city areas.³⁴

Despite Congress' concern with promoting economic development through bank loans, there was a limit to how far Congress was willing to go to use bank loans to achieve this goal. Congress did not want the CRA and HMDA to compromise the

²⁷ 123 CONG. REC. 17,625 (1977); President's Remarks on Signing Into Law, Housing and Community Development Act of 1977, 13 WEEKLY COMP. PRES. DOC. 1777 (Oct. 12, 1977); H.R. REP. NO. 561, 94th Cong., 1st Sess. 11 (1975). See Taibi, *supra* note 19, at 1114-15 (noting that Congress passed the CRA under a liberal civil rights model as applied to the banking context which will ensure that banks lend in low-income communities); Swire, *supra* note 19, at 366 (noting that Congress sought to encourage investment in low and moderate income communities through the CRA).

²⁸ 12 U.S.C. § 2901(a)(3) (1994).

²⁹ 123 CONG. REC. 17,630 (1977).

³⁰ 123 CONG. REC. 31,887 (1977).

³¹ H.R. CONF. REP. NO. 634, 95th Cong., 1st Sess. 76 (1977).

³² *Id.*; 123 CONG. REC. 17,603 (1977).

³³ H.R. REP. NO. 561, 94th Cong., 1st Sess. 4 (1975).

³⁴ H.R. CONF. REP. NO. 634, 95th Cong., 1st Sess. 76 (1977).

safety and soundness of banks.³⁵ The HMDA's statement of purpose indicates it is not intended to "encourage unsound lending practices or the allocation of credit."³⁶ Similarly, the CRA's statement of purpose indicates that the agencies are simply to "encourage" banks to meet community credit needs.³⁷ As a result of this Congressional concern with safety and soundness, neither the CRA nor the HMDA establish lending targets for low-income communities or force banks to make particular types of loans or low-rate loans to individuals from low-income neighborhoods.³⁸

2. Agency Approach to Increasing Lending

Congress left to the federal banking regulatory agencies the task of resolving the CRA's tension between the goals of increasing lending levels to low-income neighborhoods and avoiding credit allocation.³⁹ The agencies' resolution of this tension has resulted in enforcement policies which have undermined CRA's effectiveness.⁴⁰

³⁵ *But see* Macey & Miller, *supra* note 19, at 295, 321-24 (noting that the CRA by its very nature impairs safety and soundness).

³⁶ 12 U.S.C. § 2801(c) (1994). *But see* Macey & Miller, *supra* note 19, at 309 (arguing that CRA necessarily allocates credit by directing it to lower-value uses).

³⁷ 12 U.S.C. § 2901(b) (1994).

³⁸ Cowell & Hagler, *supra* note 4, at 86 (noting that the CRA has "no specific mandates about how to accomplish satisfactory credit policies" and that it only "encourages" banks to meet the credit needs of their local communities); Peter D. Schellie, *Current Developments with the Community Reinvestment Act*, 42 BUS. LAW. 943, 950 (1987) (recognizing the Federal Reserve Board's interpretation that "the CRA [does not] dictate a bank's product mix or the proportion of funds designated for particular borrowers").

³⁹ *See* Art, *supra* note 5, at 1073-74 (noting that Congress "carefully avoided rigid government credit allocation" by imposing a requirement of "good-faith efforts to improve lending practices" in low- and moderate-income neighborhoods).

⁴⁰ *See* SQUIRES, *supra* note 11, at 251-57 (arguing that some agencies "actually encouraged the disinvestment and redlining of inner-city and minority communities and encouraged speculative investments in white areas"); Fishbein, *supra* note 5, at 293, 296, 308; Taibi, *supra* note 19, at 1115; H. Jane Lehman, *Bank Loan Regulators Get a "D" Grade; Senate Subcommittee Says Agencies Fail on "Redlining" Tests*, WASH. POST, Feb. 6, 1993, at F2. There is some evidence that the regulators are beginning to establish stricter standards for CRA compliance. Marsico, *supra* note 11, at 200-55 (describing enforcement standards and signs that the Federal Reserve, at least, is tightening its standards); *see also* Macey & Miller, *supra* note 19, at 301-02 (noting that

In effect, the federal banking regulatory agencies have "underenforced" the CRA, resulting in less lending to low-income areas than there otherwise might have been.⁴¹

Under the current CRA regulations, the federal banking agencies are more concerned with the "process" by which a bank seeks lending opportunities than its actual lending record.⁴² Under the current CRA regulations, the agencies tend to view the CRA and HMDA as "market corrective" devices intended only to ensure that bankers have adequate information about lending opportunities in low-income neighborhoods.⁴³ The agencies assume that when banks learn about creditworthy individuals and projects in inner city areas, they will make loans to them.⁴⁴ This elevation of process over results

agencies began to enforce the CRA more strictly after 1989). It is too early to tell whether the new CRA regulations will result in stricter enforcement.

⁴¹ See Cowell & Hagler, *supra* note 4, at 92 (stating that regulatory agencies failed to require financial institutions to prove compliance with the CRA when they considered protested applications).

⁴² JEFFREY MARSHALL, *STAYING AHEAD OF CRA* 188, 191 (1992); Macey & Miller, *supra* note 19, at 330-33; Lehman, *supra* note 40; *Fed's CRA Ratings Show High Level of Compliance among 108 Banks Examined*, 6 FAIR HOUSING-FAIR LENDING, ¶ 6.4 (Dec. 1, 1990); *CRA Slowing More Acquisitions*, BANK MERGERS AND ACQUISITIONS NEWSLETTER, Vol. 7, No. 12, Oct. 1992, at 4; Marsico, *supra* note 11, at 195-200. In a recent addition to the CRA Q and A, the agencies take the position that the most important factors in evaluating a bank's lending record are "process-oriented" criteria such as whether the community delineation is reasonable, whether the bank's credit extensions are consistent with the bank's capacity and the identified needs of the community, and whether the bank's lending activity reflects a reasonable penetration into all segments of the community. See CRA Q and A, *supra* note 10. The new CRA regulations eliminate all the "process-oriented" criteria and focus only on a bank's loans, investments, and services. See 60 Fed. Reg. 22,156 (1995). There is some skepticism, however, that the regulators will abandon their focus on procedure. Jaret Seiberg, *Draft CRA Exam Guides Seen Failing To Cut Red Tape*, AM. BANKER, Oct. 9, 1995, at 1.

⁴³ See, e.g., Leonard Nakamura, *Information Externalities: Why Lending May Sometimes Need a Jump Start*, 3 BUS. REV. 3 (Jan./Feb. 1993); Lawrence J. White, *The Community Reinvestment Act: Good Intentions Headed in the Wrong Direction*, 20 FORDHAM URB. L. J. 281, 284-85 (1993).

⁴⁴ This view may be unduly optimistic. Some banks report, for example, lower loan losses in their community reinvestment portfolios than in their regular portfolios. See SQUIRES, *supra* note 11, at 263-64 (citing CALVIN BRADFORD, *PARTNERSHIPS FOR REINVESTING OF THE CHICAGO NEIGHBORHOOD LENDING PROGRAMS*, 1990). Despite this, low-income neighborhoods remain starved for credit. See Fishbein, *supra* note 5, at 296. Although safe and sound, some loans to low-income areas may be more expensive to make because they may be expensive to identify or administer. See

means that the agencies are more concerned with banks' efforts to ascertain community credit needs, establish CRA-related management procedures, and advertise, than they are with banks' actual lending records in low-income communities.⁴⁵

The agencies do not require banks to meet any particular credit need, but instead give them a large degree of discretion as to which needs they will meet. Even if a community documents an unmet credit need, a bank is allowed to decide not to meet it.⁴⁶ For example, a community might demonstrate a credit need for affordable rental housing. Nevertheless, if a bank does not make commercial real estate loans, it need not change its business to make such loans.⁴⁷ While this may be consistent with the terms of the CRA, which does not require a bank to make any particular type of loan, under the current CRA enforcement regime, the agencies do not seem to do enough to "encourage" banks to make these loans, as the CRA requires. In fact, it appears that the Federal Reserve does not even

SQUIRES, *supra* note 11, at 28-30, 264. *But see* Macey & Miller, *supra* note 19, at 319-20 (arguing that "despite occasional profitable CRA loans, the general effect of the CRA is to reduce depository institution safety and soundness"). However, a handful of small community development banks, which specialize in making loans in low-income areas, have been profitable and competitive with other banks. *See* Dean Foust & David Greising, *Banks that Believe in Many Towns Called Hope*, BUS. WK., Nov. 30, 1992, at 89; Elizabeth Leech, *Investing in the Community*, MAG. OF BANK MGMT., Aug. 1992, at 33. *See also* Swire, *supra* note 19, at 354-55.

⁴⁵ *See, e.g.*, Former OCC Official: *Some CRA Assessment Categories "More Equal than Others,"* 6 FAIR HOUSING-FAIR LENDING No. 7, ¶ 7.2 (Jan. 1, 1991); Marsico, *supra* note 11, at 195-255. Under the new CRA regulations, this will change, as the only relevant factors will be lending, investment, and services. *See* 60 Fed. Reg. 22,156. Nevertheless, these new standards still do not require a bank to meet lending targets, to make particular loans, or offer rate concessions. The standards for evaluating CRA compliance remain highly subjective and may cause the agencies to continue to focus on process. *See* Seiberg, *supra* note 42.

⁴⁶ Leonard Barman, et al., *The Community Reinvestment Act: A Preliminary Empirical Analysis*, 45 HUSTINGS L.J. 383, 394 (1994); Andrew Miller, *The New York Proposal to Revise the Community Reinvestment Act: A Quantitative Step Towards Objectivity and Effectiveness*, 43 CATH. U. L. REV. 951, 985 (1994).

⁴⁷ *See, e.g.*, Manufacturers Hanover Trust Co., 77 Fed. Res. Bull. 493, 496 n.20 (1991); C & S Sovran Corp., 76 Fed. Res. Bull. 779, 783 n.22 (1990); Citicorp, 68 Fed. Res. Bull. 499, 501 (1982). *But see* Macey & Miller, *supra* note 19, at 317-18 (arguing that the CRA forces banks to enter lines of business or invest their assets in ways inconsistent with their expertise and existing business). Under the new regulations, this policy would not change.

question whether a bank's decision to reject a loan is consistent with the bank's business strategy, size, and financial condition, or determine whether the bank has so much as considered making that type of loan in response to ascertained community credit needs.⁴⁸

Under the current CRA enforcement scheme, the regulatory agencies have developed several criteria for evaluating bank lending records,⁴⁹ but the agencies have not established the relative weight of each criterion or how to deal with a bank that satisfies some of the criteria but not others.⁵⁰ Nor have the agencies established numerical standards for evaluating whether a bank satisfies these criteria. There are no guidelines, for example, to determine whether the number and dollar amount of a bank's loans in its community are sufficient to meet the community's credit needs, whether differences in lending levels between predominantly low-income or minority communities and predominantly white or wealthy communities are too high, or whether the higher rejection rates faced by minority loan applicants are too high. This absence of numerical standards makes it difficult for a community group to successfully question a bank's lending record. While neither the CRA nor the HMDA permit the agencies to establish credit quotas, an objective, non-binding guideline to determine whether a bank's lending record is acceptable under the CRA would not constitute a quota.⁵¹

⁴⁸ See, e.g., *Manufacturers Hanover Trust*, 77 Fed. Res. Bull. at 496 n.20.

⁴⁹ These criteria include the bank's efforts to ascertain the credit needs of its community and advertise its credit products, the extent of the bank's board of directors' and upper management's participation in CRA efforts, evidence of discriminatory credit practices, the geographic distribution of the bank's loans, the bank's definition of its local lending community, the type and extent of a bank's lending within its lending community, the bank's record of opening and closing branches, the bank's customer services and deposit products, and the bank's participation in insured and community development lending programs and projects. See 12 C.F.R. § 563e.7 (1994) (OTS); § 345.7 (1994) (FDIC); § 25.7 (1994) (OCC); and § 228.7 (1994) (Federal Reserve).

⁵⁰ See Fishbein, *supra* note 5, at 303; Macey & Miller, *supra* note 19, at 326-27. This will change under the new regulations, which describe how the bank's lending, investment, and service record would be combined to determine the bank's overall CRA rating. See 60 Fed. Reg. 22,156 (1995).

⁵¹ See, e.g., Swire, *supra* note 19, at 352 (suggesting objective guidelines based on relative performance of similar banks). The new CRA regulations do not contain numerical standards. However, an earlier draft of the regulations contained a "market-share" test for evaluating a large bank's lending record. See 58 Fed. Reg. 67,466 (1993). Under the "market share" approach, a bank's market share in low-income

*B. Strengthening Communities:
HMDA Data and CRA Challenges*

1. HMDA Data

When Congress passed the HMDA, it envisioned that data about home mortgage lending records would be used as a tool for community groups to learn about and to fight redlining.⁵² The HMDA's explicit purpose is to provide the public "with sufficient information to . . . determine whether depository institutions are fulfilling their obligations to serve the housing needs of the communities and neighborhoods in which they are located."⁵³ Congress hoped that community residents and public officials would use HMDA data to develop strategies to fight redlining and bring money back into their communities.⁵⁴ The HMDA data "will allow people to have a voice in what happens in their neighborhoods."⁵⁵ One witness who testified at Congressional hearings on the HMDA summed up this attitude: "Community groups, armed with the facts, can protect the integrity of their neighborhoods and their own vital interests."⁵⁶

HMDA data have demonstrated lending disparities⁵⁷ which have, in turn, galvanized low-income communities to force banks to increase their lending.⁵⁸ For example, the HMDA data from 1990-1993 indicate that rejection rates for African-American home

neighborhoods would be compared to its share in wealthy neighborhoods. *Id.* The "market share" test was eliminated in a subsequent draft CRA proposal as opponents labeled it a credit quota. *See* 59 Fed. Reg. 51,235 (1994).

⁵² 121 CONG. REC. 27,621, 34,453 (1975). *See supra* text accompanying notes 24-26.

⁵³ 12 U.S.C. § 2801(b) (1994). *See also* 121 CONG. REC. 25,160 (1975) (noting that depository institutions are required to establish a public record file to provide the public with information to determine whether banks are giving reasonable service to the community).

⁵⁴ H.R. REP. NO. 561, 94th Cong., 1st Sess. 14, 20 (1975); S. REP. NO. 187, 94th Cong., 1st Sess. 1, 2 (1975); 121 CONG. REC. 25,162, 34,455 (1975).

⁵⁵ 121 CONG. REC. 34,576 (1975).

⁵⁶ S. REP. NO. 187, 94th Cong., 1st Sess. 4 (1975).

⁵⁷ Glenn B. Canner & Dolores Smith, *Expanded HMDA Data on Residential Lending: One Year Later*, 78 Fed. Res. Bull. 801, 801 (1992).

⁵⁸ *Id.*

mortgage applicants were more than twice as high as rates for whites,⁵⁹ and the rejection rates for Latinos were nearly fifty percent higher.⁶⁰ These disparities have resulted in a wave of negative publicity about banks around the country, as newspapers and community activists released study after study documenting discriminatory rejection rates.⁶¹

Despite these dramatic racial disparities in lending rates, the agencies have generally not been willing to use only disparities in the HMDA data to investigate whether banks are discriminating.⁶² The primary reasons are that HMDA data do not provide enough information about the creditworthiness of a loan applicant,⁶³ do not provide information about the adequacy of the loan collateral, and underestimate the extent of a bank's lending in low-income

⁵⁹ *Id.*

⁶⁰ See Jaret Seiberg, *Bias Probes Seen Justified by Latest Home Loan Data*, AM. BANKER, Oct. 27, 1994, at 2; Glenn B. Canner et al., *Residential Lending to Low-Income and Minority Families: Evidence from the 1992 HMDA Data*, 80 Fed. Res. Bull. 79 (1994); Canner & Smith, *supra* note 57 and accompanying text; Glenn B. Canner & Dolores S. Smith, *Home Mortgage Disclosure Act: Expanded Data on Residential Lending*, 77 Fed. Res. Bull. 859 (1991). The rejection rates were as follows:

	1990	1991	1992	1993
African-American	33.6%	37.6%	35.9%	34.0%
Latino	21.4%	26.6%	27.3%	25.1%
White	14.2%	17.3%	15.9%	15.0%

⁶¹ See, e.g., Theresa Carson, *Las Vegas Groups Charge Redlining by Banks*, AM. BANKER, June 15, 1992, at 6; Richard Buck & Michele Matassa Flores, *Blacks Get Rejected More Often for Loans*, SEATTLE TIMES, Oct. 22, 1991, at A1; Christopher Dinsmore, *Wachovia Rejects 27% of Black Loan Applicants*, CHARLOTTE BUS. J., Oct. 21, 1991, at 1; Dee Gill, *Texas Bank Fails to Mend its Record on Minority Loans*, HOUS. CHRON., Sept. 15, 1992, at 1; Joanne Johnson and Brant Houston, *Inequality Seen in Approvals of Home-Loan Applications*, HARTFORD COURANT, Mar. 21, 1993, at A1; Thomas J. Leuck, *Racial Differences in Mortgage Lending*, N.Y. TIMES, July 19, 1992, at C1; *Loan Figures Fall Among Economic, Racial Lines*, AUSTIN BUS. J., Aug. 24, 1992, at 1; David R. Sands, *D.C. Banks Said To Favor White-Area Investments*, WASH. TIMES, June 5, 1992, at C1; Paulette Thomas, *Blacks Can Face a Host of Trying Conditions in Getting Mortgages*, WALL ST. J., Nov. 30, 1992, at 1; Paulette Thomas, *Federal Data Details Pervasive Racial Gap in Mortgage Lending*, WALL ST. J., Mar. 31, 1992, at A1; Paulette Thomas, *Minority-Area Lenders Faulted in ACORN Study*, WALL ST. J., June 5, 1992, at A2.

⁶² Meridian Bancorp., Inc., 78 Fed. Res. Bull. 942, 947 (1992).

⁶³ See Marsico, *supra* note 11, at 240 and accompanying text.

communities because the HMDA data do not include consumer, small business, or economic development loans.⁶⁴ As a result of the regulators' indifference toward HMDA data, the Federal Reserve has largely ignored demonstrated lending disparities in CRA challenges.⁶⁵ While this critique of the HMDA may be accurate, such disparities should, at a minimum, raise a red flag and lead to further investigation.⁶⁶

2. CRA Challenges

Congress saw the opportunity to challenge a bank's application on CRA grounds as essential to a "carrot and stick" approach of encouraging banks to lend within inner city areas.⁶⁷ Nevertheless, the agencies have emphasized the carrot over the stick, and have rarely granted CRA challenges.⁶⁸ Between passage of the

⁶⁴ Canner & Smith, *supra* note 57 and accompanying text.

⁶⁵ See Marsico, *supra* note 11, at 240-41, n.398; Comerica, Inc., 79 Fed. Res. Bull. 31, 34-35 (1993); *Meridian Bancorp*, 78 Fed. Res. Bull. at 947; *Banc One Corp.*, 78 Fed. Res. Bull. at 935-36; *CoreStates Fin. Corp.*, 78 Fed. Res. Bull. 779, 783 (1992); *Banc One Corp.*, 78 Fed. Res. Bull. 699, 703 (1992); *Comerica, Inc.*, 78 Fed. Res. Bull. 554, 564-65 (1992); *First of Am. Bank Corp.*, 78 Fed. Res. Bull. 371, 375 (1992); *BankAmerica Corp.*, 78 Fed. Res. Bull. 338, 355-56 (1992); *First Bancshares of St. Landry, Inc.*, 78 Fed. Res. Bull. 136, 138 (1992); *Chemical Banking Corp.*, 78 Fed. Res. Bull. 74, 81-82 (1992); *U.S. Bancorp*, 76 Fed. Res. Bull. 1053, 1054-56 (1990); *AmSouth Bancorp*, 76 Fed. Res. Bull. 957, 959 (1990); *SouthTrust Corp.*, 76 Fed. Res. Bull. 647, 648-49 (1990); *Meridian Bancorp, Inc.*, 74 Fed. Res. Bull. 51, 52 (1988); *First Midwest Bancorp, Inc.*, 73 Fed. Res. Bull. 459, 460 (1987); *National City Corp.*, 68 Fed. Res. Bull. 427 (1982); *Society Corp.*, 66 Fed. Res. Bull. 351, 353 (1980); *AmeriTrust Corp.*, 66 Fed. Res. Bull. 238, 241 (1980).

The Justice Department has now taken the lead in using HMDA to investigate bank lending records. Robert G. Boehmer, *Mortgage Discrimination: Paperwork and Prohibitions Prove Insufficient—Is it Time for Simplifications and Incentives*, 21 HOFSTRA L. REV. 603, 656 (1993). The Justice Department has sued three banks which had significant HMDA disparities: Decatur Federal Savings and Loan in Atlanta, Shawmut Bank in Boston, and Chevy Chase Federal Savings and Loan in Maryland. Canner & Smith, *supra* note 57, at 817.

⁶⁶ See, e.g., *Banc One Corp.*, 78 Fed. Res. Bull. 932, 935-36 (1992).

⁶⁷ 123 CONG. REC. 17,630, 17,631 (1977). See *supra* text accompanying note 11.

⁶⁸ Similarly, the regulatory agencies have given high scores to banks on the periodic CRA assessments they conduct. See Marsico, *supra* note 11, at 239-41 and accompanying text; see, e.g., *Bank America Corp.*, 78 Fed. Res. Bull. at 355-56. In the first two years after CRA ratings became public in 1990, only fourteen percent of

CRA in 1977 and 1988, the regulatory agencies denied only eight out of approximately 50,000 applications based on CRA grounds.⁶⁹ The Federal Reserve did not deny an application based on CRA grounds until 1989.⁷⁰ In 1991 and 1992, eighty-five CRA challenges were filed and only five were granted.⁷¹

Even though the threat of a successful challenge to a bank's application is minimal, the application process and the threat of a challenge offer community groups other sources of leverage in negotiating CRA lending agreements. These include additional expense for the bank, delay in approval of the deal, negative publicity for the bank, and administrative hearings on the challenge.⁷² As a result, threats to challenge and actual challenges have resulted in commitments by banks to lend billions of dollars to low- and

all banks examined have received less than a satisfactory score, despite the evidence of lending discrimination demonstrated by HMDA data. See SQUIRES, *supra* note 11, at 267. In 1994, 94% of banks received grades of satisfactory or higher. Shannon Henry, AM. BANKER, Jan 26, 1995, at 10.

⁶⁹ See MARSHALL, *supra* note 42, at 2; Fishbein, *supra* note 5, at 298 (stating that eight out of 40,000 applications were denied based on CRA grounds).

⁷⁰ See Continental Bank Corp., 75 Fed. Res. Bull. 304, 305 (1989) (characterizing bank's record of performance as "inadequate" while rejecting application). Since 1991, however, the Federal Reserve has denied several applications on CRA grounds. See, e.g., First Colonial Bankshares Corp., Fed. Res. Sys., May 18, 1993; Gore-Bronson Bancorp., Inc., 78 Fed. Res. Bull. 784, 787 (1992); First Interstate BancSys. of Montana, Inc., 77 Fed. Res. Bull. 1007, 1009 (1991). In addition, the Federal Reserve issued its first two cease and desist orders against banks for CRA violations in 1991 and 1992. See *Columbus Junction State Bank*, Fed. Res. Sys., Doc. No. 92-076-WA/RB-SM (1992); *Farmers and Merchants Bank of Long Beach*, Fed. Res. Sys., Doc. No. 91-080-B-SM (1991).

⁷¹ Claudia Cummins, *CRA Objections Blocked Only Three Filings Last Year*, AM. BANKER, Mar. 23, 1993, at 1.

⁷² See Macey & Miller, *supra* note 19, at 322-23; *CRA Slowing More Acquisitions*, 7 BANK MERGERS AND ACQUISITIONS 1, 2-3, Oct. 1992; Theresa Carson, *BankAmerica Faces Ordeal: 145 to Testify*, AM. BANKER, Jan. 14, 1992, at 11; Geoff Cooper, *Merger Between Associated, F & M Hits Fair Lending Project Roadblock*, BUS. J. MILWAUKEE, Dec. 23, 1991, at § 1, 6; Mike Dorning, *Regulatory 'Delays' Kill Geneva Deal, Harris Says*, CHI. TRIB., Sept. 12, 1991, at Bus. 3; Richard D. Hylton, *Banks Are Prodded To Offer Better Service in Poor Areas*, N.Y. TIMES, Aug. 7, 1990, at D1; Michael Quint, *Critics Gain Time To Fight Bank Merger*, N.Y. TIMES, Oct. 21, 1991, at D7.

moderate-income communities.⁷³ If, however, the agency's enforcement policies had been more strict, these commitments may have been larger.

III. Using The CRA and HMDA to Help Create and Support Community Development Financial Institutions

Although they promote economic community development and community empowerment, the CRA and HMDA, because of internal tensions and underenforcement, go only so far in fighting poverty. While community groups have been able to use the CRA and HMDA to gain billions of dollars in lending commitments,⁷⁴ they cannot use the CRA and HMDA to force banks to meet all or even most pressing community credit needs. Nevertheless, community groups have discovered a way to sidestep the CRA's limitations and use it more effectively to promote economic development and community empowerment: by using the CRA and HMDA to support community development financial institutions (CDFIs).⁷⁵

A. Community Development Financial Institutions

The primary advantage of using the CRA to support CDFIs is that, in contrast to traditional banks, CDFIs are consciously designed to have the expertise, desire, and accountability necessary to promote community-controlled economic development.⁷⁶ As such,

⁷³ One estimate counts more than 300 such agreements totaling \$18 billion in lending to low- and moderate-income communities. SQUIRES, *supra* note 11, at 2. Another estimate counts \$30 billion in CRA commitments. Fishbein, *supra* note 5, at 294. For descriptions of various provisions of CRA commitments, see Marsico, *supra* note 11, at 255-64.

⁷⁴ See *supra* note 4 and accompanying text.

⁷⁵ See discussion *infra* parts III.A, III.B.

⁷⁶ See SQUIRES, *supra* note 11, at 243. A comprehensive description of the principles of community lending appears in Association for Enterprise Opportunity, Center for Community Self-Help, Community Capital Bank, First Nations Development Institute, National Association of Community Development Loan Funds, National Federation of Community Development Credit Unions, and Woodstock Institute, *Principles of Community Development Lending & Proposals for Key Federal Support*, Jan. 25, 1993.

they are more effective than banks in building the community's economic infrastructure and eliminating poverty.

1. Expertise and Experience in Community Lending

Many different types of expertise are necessary to successfully make loans in low-income communities. For example, making a loan to purchase and rehabilitate a deteriorated building for the purpose of creating affordable rental housing requires expertise in construction, management, government subsidy programs, and packaging multi-party deals that involve developers, investors, grants, and lenders.⁷⁷ The staff, volunteers, and board members of community development financial institutions possess the necessary expertise to carry out these loans.⁷⁸

Expertise is also required to evaluate the creditworthiness of low-income applicants for home mortgage loans. Many loan applicants do not satisfy the requirements of the standard mortgages offered by the banking industry.⁷⁹ Any number of factors might explain this, including low income, lack of credit history, an intermittent employment record, more than one family member living in a household, or high debt. Many of these obstacles can be explained or solved, but not by a loan officer located in a central office outside the community.⁸⁰ Rather, a person who lives in and knows the community's culture is necessary.⁸¹

A rapidly emerging and popular part of CRA agreements and initiatives recognizes this need for expertise. Banks are funding community groups to provide loan counseling for community residents to make the residents more creditworthy and to assist them

⁷⁷ See SQUIRES, *supra* note 11, at 243, 265.

⁷⁸ See Institute for Community Economics, *The Community Loan Fund Manual 2-1, 2-16 (1987)* [hereinafter *Institute for Community Economics*]; MARSHALL, *supra* note 42, at 160-61; Swire, *supra* note 19, at 354-55; Roland Diniz, *Community Loan Funds as a Development Tool*, N.Y.L.J., Aug. 30, 1988, at 3.

⁷⁹ See SQUIRES, *supra* note 11, at 264.

⁸⁰ *Id.*

⁸¹ See STEWART E. PERRY, *COMMUNITIES ON THE WAY: REBUILDING LOCAL ECONOMIES IN THE UNITED STATES AND CANADA* 39-40 (1987).

in filing bankable home mortgage applications.⁸² In connection with these programs, and in consultation with community groups, banks are changing their underwriting criteria to make them consistent with safety and soundness and to make sure that they do not have a discriminatory impact on minority or low-income home purchasers.⁸³

2. *Desire To Make Loans in the Community*

CDFIs consciously try to “reinvent” banking to ensure that credit is available to meet all of a community’s needs.⁸⁴ A successful community development lender must invest more time and technical assistance to make projects work, to take risks traditional lenders are not willing to take, to develop strategies to ensure that such risks are prudent, to earn less of a return, and to cut administrative costs creatively.⁸⁵

One important technique CDFIs have developed to ensure that loans are safe and sound is to provide technical assistance and advice to loan applicants both prior to making the loan and throughout the

⁸² See SQUIRES, *supra* note 11, at 142; Kenneth Cline, *NCNB, NAACP in Loan Program; Bank to Fund Minority Financial Centers in Five Cities*, AM. BANKER, Dec. 20, 1991, at 7; Timothy R. Dougherty, *Closing the Gap: Stung by Charges of Bias Against Minorities, Lenders are Trying To Do the Right Thing*, NEWSDAY, Jan. 30, 1993, at 30; Leslie Wayne, *New Hope in Inner Cities: Banks Offering Mortgages*, N.Y. TIMES, Mar. 14, 1992, at A1.

⁸³ See SQUIRES, *supra* note 11, at 16, 247; Fishbein, *supra* note 5, at 299; J. Linn Allen, *Banks, Activists Tailor Loans to Communities*, CHI. TRIB., Sept. 1, 1992, at 1; Jeff Brown, *Philadelphia Leads in Lending to Minorities*, PHIL. INQUIRER, June 5, 1992, at A1; Steve Klinkerman, *Community Relations: Banks Cautiously Expand Credit Counseling Efforts*, AM. BANKER, Jan. 27, 1992, at 5. Examples include allowing applicants with no credit history to show a good history of paying rent or utility bills, considering regular employment as opposed to consecutive years employed at the same job, and counting household income from all sources, including public assistance. See Marsico, *supra* note 11, at 216-17, 257-58.

⁸⁴ Their mission seems consistent with Roberto Unger’s notion of creating an “alternative institutional definition of the market.” See ROBERTO UNGER, *FALSE NECESSITY, ANTI-NECESSITARIAN SOCIAL THEORY IN THE SERVICE OF RADICAL DEMOCRACY, PART I OF POLITICS, A WORK IN CONSTITUTIONAL SOCIAL THEORY* 480 (1987).

⁸⁵ See MARSHALL, *supra* note 42, at 105-08.

life of the loan.⁸⁶ CDFIs spend the majority of their time assessing the creditworthiness of a project,⁸⁷ pointing out potential problems, developing sound financial plans, identifying other sources of capital, securing other providers of technical assistance such as architects and engineers, and providing assistance if the borrower is having difficulties paying the loan.⁸⁸

CDFIs make loans that traditional banks are not willing to make.⁸⁹ One type of CDFI, a community development loan fund, makes loans to non-traditional development projects and organizations to which banks are generally unwilling to lend.⁹⁰ These projects include community land trusts and mutual housing associations,⁹¹ low-income tenant associations seeking to purchase their buildings, non-profit organizations seeking to develop affordable housing,⁹² community development corporations seeking to start businesses or economic stimulus projects, and consumer cooperatives.⁹³ They are also willing to make unsecured loans or accept a third or fourth mortgage.⁹⁴

⁸⁶ See SQUIRES, *supra* note 11, at 263; MARSHALL, *supra* note 42, at 161; Institute for Community Economics, *supra* note 78, at 2-14, 2-16.

⁸⁷ PERRY, *supra* note 81, at 40.

⁸⁸ See Institute for Community Economics, *supra* note 78, at 2-1; Diniz, *supra* note 78, at 3.

⁸⁹ See SQUIRES, *supra* note 11, at 19.

⁹⁰ See Diniz, *supra* note 78, at 3; MARSHALL, *supra* note 42, at 160; Rachelle Garbarine, *A Loan Pool Helps Provide Affordables*, N.Y. TIMES, Feb. 2, 1992, at § 10, p. 6. The National Association of Community Development Loan Funds was started in 1989 and had thirty-six members. *Id.* As of June 30, 1992, there were forty-one funds with \$60 million in loans to 1236 borrowers. Christine Dugas, *Picking Up the Slack, Credit Unions Take the Place of Banks for Poor and Even the Homeless*, NEWSDAY, Feb. 22, 1993, at 21.

⁹¹ These are non-profit entities that own land and lease it to tenants for long terms at affordable rents. *See, e.g.*, Institute for Community Economics, *North Camden Land Trust*, COMMUNITY ECONOMICS, Spring 1993, at 3; *Provisions for CLTs*, *id.* at 10.

⁹² MARSHALL, *supra* note 42, at 160.

⁹³ See Institute for Community Economics, *supra* note 78, at 1-7; Laura A. Kiernan, *Cash-Poor Look Past Traditional Banks*, BOSTON GLOBE, Mar. 8, 1993, at 13 (\$190,000 loan to association of mobile home owners as downpayment on land); *see also* Garbarine, *supra* note 90, at 6 (describing one community loan fund which finances projects such as construction).

⁹⁴ See Diniz, *supra* note 78, at 4.

Although community development loan funds take risks that banks will not,⁹⁵ they must be prudent in making their loans. As a result, they have developed new ways of ensuring safety.⁹⁶ Like banks, community development loan funds obtain specific collateral as a guarantee for their loans, accumulate permanent capital to cover losses, and employ specialists to screen loans.⁹⁷ Unlike banks, they provide intensive technical assistance to ensure that borrowers are creditworthy and are able to repay their loans.⁹⁸ They also screen borrowers for a shared commitment to the goals of the community development loan fund, in the belief that this common commitment will create additional motivation to repay the loan.⁹⁹ Finally, community development loan funds limit the risk to any particular investor by pooling investors' capital.¹⁰⁰

Another example of a CDFI which is dedicated to taking non-traditional risks is a micro-enterprise loan fund.¹⁰¹ The vanguard among these funds lend very small loans (as low as \$500)¹⁰² for new and start-up businesses that banks are generally unwilling to make because most of these new business owners lack the traditional indicia of creditworthiness.¹⁰³ Micro-enterprise loan funds operate on the principle that desire, hard work, training, moral support, technical assistance, and peer pressure can create creditworthiness.¹⁰⁴ They generally operate revolving loan funds, in which new loans are made

⁹⁵ *Id.* at 3.

⁹⁶ Community development funds generally have a very low default rate. See PERRY, *supra* note 81, at 154-55.

⁹⁷ See Institute for Community Economics, *supra* note 78, at 2-14.

⁹⁸ Diniz, *supra* note 78, at 4.

⁹⁹ *Id.*

¹⁰⁰ *Id.* at 3.

¹⁰¹ MARSHALL, *supra* note 42, at 161-62.

¹⁰² *Id.* at 161.

¹⁰³ See, e.g., Miriam Hill, *Working for Herself: Group Helps Women Succeed in Business*, PLAIN DEALER, Dec. 29, 1992, at 1F (profiling Women's Entrepreneurial Growth Organization, which guarantees small loans for women entrepreneurs); Kiernan, *supra* note 93, at 11 (\$1500 start-up loan for sewing equipment); Abby Scher, *Where Credit Is Due*, CITY LIMITS 6, Oct. 1991; Aaron Jaffe, *Mutual Aid*, CITY LIMITS 8 (May 1992); David Wessel, *Two Unusual Lenders Show How 'Bad Risks' Can Be Good Business*, WALL ST. J., June 23, 1993, at 1; Robert McNatt, *A Kiss, a Grant, and Maybe a Customer*, CRAIN'S N.Y. BUS., Sept. 7, 1992, at 3.

¹⁰⁴ See Macey & Miller, *supra* note 19, at 344-45.

as old ones are repaid.¹⁰⁵ Borrowers are placed in small peer groups with applicants who are to receive their loans out of the repaid funds.¹⁰⁶ In this context, applicants can place collegial pressure on borrowers to repay their loans.¹⁰⁷ Applicants also have a chance to see first-hand the ups and downs of running a business.¹⁰⁸ Together, applicants and borrowers can share insights and ideas.¹⁰⁹

Banks are also unwilling to risk opening branches in low-income communities.¹¹⁰ Another type of CDFI, a community development credit union,¹¹¹ meets this need. Community development credit unions are, by definition, located in low-income communities.¹¹² They make retail loans to people who do not bank at a traditional bank for one of several reasons, including lack of a nearby branch,¹¹³ unaffordable fees, or high minimum deposit requirements.¹¹⁴ Community development credit unions have traditionally made loans for consumer purchases, education, and household needs.¹¹⁵ Now they are branching into housing, home improvement, and small business loans as well.¹¹⁶

Since many CDFI borrowers cannot afford market rates, CDFIs must find ways to make loans at lower rates when necessary.¹¹⁷ However, the technical assistance they provide to

¹⁰⁵ MARSHALL, *supra* note 42, at 161.

¹⁰⁶ See Macey & Miller, *supra* note 19, at 344-45 (describing "lending clubs" into which members make contributions which are then loaned to the member voted to have the best business plan); see also Kiernan, *supra* note 93, at 13 (describing lending clubs as groups from which members obtain loans for which the group is collectively responsible).

¹⁰⁷ See, e.g., Macey & Miller, *supra* note 19, at 344-45 (noting that "a variety of nonlegal community sanctions" exist to pressure group members to repay loans).

¹⁰⁸ *Id.*

¹⁰⁹ *Id.*

¹¹⁰ MARSHALL, *supra* note 42, at 161; Wessel, *supra* note 103, at 1.

¹¹¹ MARSHALL, *supra* note 42, at 88.

¹¹² *Id.* at 88-89.

¹¹³ *Id.*

¹¹⁴ Kiernan, *supra* note 93, at 15.

¹¹⁵ See Institute for Community Economics, *supra* note 78, at 2-10 to 2-11; *Surviving in the City: Low-Income Credit Union Finds Key to Solvency*, PLAIN DEALER, Nov. 4, 1992, at 1D.

¹¹⁶ Kiernan, *supra* note 93, at 14.

¹¹⁷ See PERRY, *supra* note 81, at 153-54.

borrowers raises the administrative costs of their loans.¹¹⁸ Thus, CDFIs must be willing to reduce expenses elsewhere.¹¹⁹

Most CDFIs are non-profit.¹²⁰ While they must still earn a sufficient return on their loans to keep them viable, non-profit status reduces the necessary rate of return.¹²¹ Investors in CDFIs are generally private individuals, church organizations, banks seeking to satisfy their CRA obligations, and others who also may be willing to accept a lower rate of return on their investments.¹²² Non-profit status has another advantage: CDFIs can receive tax-deductible donations of capital or operating expenses.¹²³ CDFIs are also willing to reduce overhead through limiting expenses for travel, information-gathering, or public relations, using donated facilities and equipment and pro bono services, and paying modest salaries.¹²⁴

3. *Accountability to the Community*

CDFIs are designed to be accountable to the communities they serve.¹²⁵ Meeting the needs of a particular community is the very reason for the existence of most community development financial institutions.¹²⁶ They are generally located in and managed by residents of the communities they serve.¹²⁷ Community development credit unions, for example, are cooperative organizations run by their member depositors who must reside (with some exceptions) in

¹¹⁸ See SQUIRES, *supra* note 11, at 263; Institute for Community Economics, *supra* note 78, at 2-16.

¹¹⁹ SQUIRES, *supra* note 11, at 263.

¹²⁰ See PERRY, *supra* note 81, at 153-54.

¹²¹ *Id.*

¹²² See *id.*; Institute for Community Economics, *supra* note 78, at 2-1, 2-11; Garbarine, *supra* note 90, at 6.

¹²³ See Institute for Community Economics, *supra* note 78, at 2-12.

¹²⁴ *Id.* at 2-16 to 2-17; MARSHALL, *supra* note 42, at 160-61.

¹²⁵ See SQUIRES, *supra* note 11, at 269 (noting that reinvestment programs and policies need to be tailored toward the communities they are designed to improve).

¹²⁶ See Institute for Community Economics, *supra* note 78, at 1-1; Dugas, *supra* note 90, at 21.

¹²⁷ *Id.* at 2-1; Diniz, *supra* note 78, at 3.

the geographic area served by the credit union, and which make loans to their members only.¹²⁸

*B. The CRA's Support for Community Development
Financial Institutions*

Community groups are increasingly realizing that under the CRA, banks are encouraged to support community economic development efforts of non-profit community groups that promote economic development, including CDFIs.¹²⁹ Two of the criteria the agencies currently use to evaluate a bank's CRA record indicate that a bank can help satisfy its CRA obligations by supporting CDFIs: the extent and type of credit a bank extends within its community and the bank's participation in community development projects and programs.¹³⁰ Loans or grants to CDFIs, which in turn can lend this money to help meet community credit needs, satisfy both of these criteria.¹³¹

Two recent additions to one of the agencies' current joint CRA policy statements also encourage banks to support CDFIs.¹³² The regulatory agencies made clear that banks can help satisfy their CRA obligations through investments or loans to alternative lending institutions such as CDFIs, even if many of the loans made by the CDFIs are not within the bank's lending community.¹³³ In particular, wholesale banks are encouraged to meet their CRA obligations by making loans and grants to organizations like CDFIs.¹³⁴ Finally, it has recently become clear that cash grants, free advice, or free assistance to community organizations also help satisfy a bank's CRA

¹²⁸ *Id.* at 2-14; Macey & Miller, *supra* note 19, at 313 n.79 (noting that credit union's practice of loaning to members is likely sufficient community "investment" for purposes of the CRA).

¹²⁹ See *infra* notes 130-34 and accompanying text:

¹³⁰ See 12 C.F.R. §§ 228.7(i)(k) (Federal Reserve), 25.7(i)(k) (OCC), 345.7(i)(k) (FDIC) and 563e.7(i)(k) (OTS) (1994).

¹³¹ See Marsico, *supra* note 11, at 213-15, 218-19, 225-26, 249-53.

¹³² These additions were made to the CRA Q and A on March 25, 1992. See 57 Fed. Reg. 10,899. The current version of the CRA Q and A was issued on February 19, 1993. See CRA Q and A, *supra* note 10.

¹³³ CRA Q and A, *supra* note 10.

¹³⁴ *Id.*

obligations as long as the grants support an activity that would earn CRA credit for a bank if the bank had made a loan to support the project.¹³⁵ Since a CDFI's lending would clearly earn a bank CRA credit if the bank made the loan directly, grants and loans to CDFIs would satisfy this standard.

Given this regulatory support for CDFIs, community groups are increasingly using the CRA to encourage banks to support them, and banks are more willing to do so. Many forms of support for CDFIs and similar entities have developed, including loans, investments, and grants. For example, banks have made loans to non-profit organizations, community groups, community development corporations,¹³⁶ churches,¹³⁷ small business lending programs,¹³⁸ micro-loan programs,¹³⁹ and loan pools which support affordable housing, small business, or economic development.¹⁴⁰ Banks have

¹³⁵ See, e.g., *Banc One Corp.*, 78 Fed. Res. Bull. at 935, 935 n.18; Old National Bancorp, Inc., 79 Fed. Res. Bull. 55, 58-59 (1993); First Bank System, Inc., 78 Fed. Res. Bull. 948, 951 (1993); U.S. Bancorp, 78 Fed. Res. Bull. 789, 792-93, n.27 (1993); Comerica, Inc., 78 Fed. Res. Bull. 554, 561 (1992); BankAmerica Corp., 78 Fed. Res. Bull. 338, 350 n.67 (1992); NCNB Corp., 78 Fed. Res. Bull. 141, 154 (1992); NCNB Corp., 77 Fed. Res. Bull. 119, 121 (1991).

¹³⁶ *BankAmerica Corp.*, 78 Fed. Res. Bull. at 351; *NCNB Corp.*, 77 Fed. Res. Bull. at 121 (1991); U.S. Bancorp, 76 Fed. Res. Bull. 1053, 1055 (1990); Muskingum Valley Bancshares, 76 Fed. Res. Bull. 643, 645 (1990); CoreStates Financial Corp., 76 Fed. Res. Bull. 176, 179 (1990); Manufacturers Hanover Trust Co., 75 Fed. Res. Bull. 761, 764, n.13 (1989); Mellon National Corp., 69 Fed. Res. Bull. 721, 723 (1983).

¹³⁷ *First of America Bank Corp.*, 78 Fed. Res. Bull. at 371 n.16; *BankAmerica Corp.*, 78 Fed. Res. Bull. at 351 n.74.

¹³⁸ *Meridian Bancorp, Inc.*, 78 Fed. Res. Bull. 942, 946-47 (1992); *CoreStates Financial Corp.*, 78 Fed. Res. Bull. 779, 783 (1992); *Comerica, Inc.*, 78 Fed. Res. Bull. 554, 562 (1992); *BankAmerica Corp.*, 78 Fed. Res. Bull. at 351 n.75, 353; *Chemical Banking Corp.*, 78 Fed. Res. Bull. 78, 80 (1992); *AmSouth Bancorp.*, 76 Fed. Res. Bull. 957, 959 (1990); *Manufacturers Hanover Trust Co.*, 75 Fed. Res. Bull. at 764 n.13.

¹³⁹ *Meridian Bancorp, Inc.*, 78 Fed. Res. Bull. at 946-47; *The Shorebank Corp.*, 78 Fed. Res. Bull. 619, 620 n.3 (1992); *First of America Bancorp.*, 78 Fed. Res. Bull. at 374; *BankAmerica Corp.*, 78 Fed. Res. Bull. at 351.

¹⁴⁰ CRA Q and A, *supra* note 10, at 10,904; Kenneth P. Fain & Sandra F. Braunstein, *Bank Holding Company Investments for Community Development*, 77 Fed. Res. Bull. 388, 392 (1991) [hereinafter *Investments for Community Development*]; *CoreStates Financial Corp.*, 78 Fed. Res. Bull. at 782; *Comerica, Inc.*, 78 Fed. Res. Bull. at 561; *BankAmerica Corp.*, 78 Fed. Res. Bull. at 352; *NCNB Corp.*, 78 Fed. Res. Bull. at 153, 155.

also invested in community development activities.¹⁴¹ Two popular investment vehicles are community development corporations¹⁴² and low-income housing tax credits.¹⁴³ Other potential investment vehicles are housing, employment, commercial, medical, and educational projects that benefit low-income persons.¹⁴⁴

Finally, banks have made grants to community organizations involved in local economic development.¹⁴⁵ One popular example is a grant to a community group to conduct a loan counseling program to assist community residents in applying for loans.¹⁴⁶ "In kind" grants, such as free advice through serving on a board of directors or loan review committee, developing loan applications or underwriting standards, training staff or management, or providing accounting or bookkeeping services, also help a bank satisfy its CRA obligations.¹⁴⁷

Two recent legal developments promise to make it even easier for community-based organizations to use the CRA to create and support CDFIs. First, in April 1995, the four federal bank regulatory agencies adopted new CRA regulations under which loans, investments, or grants to support CDFIs would count more toward a bank's overall CRA rating than they do now.¹⁴⁸ Second, in August 1994, Congress passed the Community Development Banking and Financial Institutions Act of 1994 (the "CDFI Act"), which created

¹⁴¹ *Investments for Community Development*, *supra* note 140, at 389; First Financial Corp., 76 Fed. Res. Bull. 671, 672 (1990); Illinois Neighborhood Development Corp., 64 Fed. Res. Bull. 45 (1978).

¹⁴² *Banc One Corp.*, 78 Fed. Res. Bull. at 935 n.20; Luxemburg Bancshares, Inc., 77 Fed. Res. Bull. 63 (1991); SouthTrust Corp., 76 Fed. Res. Bull. 647, 648 (1990); Shorebank Corp., 74 Fed. Res. Bull. 140, 141 (1988).

¹⁴³ *Banc One Corp.*, 78 Fed. Res. Bull. at 702 n.15; *BankAmerica Corp.*, 78 Fed. Res. Bull. at 350, 353; C & S Sovran Corp., 76 Fed. Res. Bull. 779, 782 (1990); First Interstate Bancorp, 73 Fed. Res. Bull. 881, 883 n.13 (1987).

¹⁴⁴ *Investments for Community Development*, *supra* note 140, at 389.

¹⁴⁵ See SQUIRES, *supra* note 11, at 247; MARSHALL, *supra* note 42, at 161.

¹⁴⁶ *U.S. Bancorp*, 78 Fed. Res. Bull. at 792; *Comerica, Inc.*, 78 Fed. Res. Bull. at 563; *BankAmerica Corp.*, 78 Fed. Res. Bull. at 353 n.93; *Chemical Banking Corp.*, 78 Fed. Res. Bull. at 82; Norwest Corp., 77 Fed. Res. Bull. 343, 345 n.13 (1991).

¹⁴⁷ See CRA Q & A, *supra* note 10; *NCNB Corp.*, 78 Fed. Res. Bull. at 148-57.

¹⁴⁸ 60 Fed. Reg. 22,156 (1995) (to be codified at 12 C.F.R. pts. 25, 228, 345, and 563e). For convenience, in describing the new regulations, this article will cite only the new OCC regulations, 12 C.F.R. pt. 25.

a \$382 million fund to provide federal financial matching support for CDFIs.¹⁴⁹

Under the new CRA regulations, the amount, extent, innovativeness, complexity, and responsiveness of a bank's community development lending, investment, and services through an intermediary such as a CDFI would be critically important factors in assessing its CRA record.¹⁵⁰ For wholesale banks, the only measure for evaluating CRA compliance would be the community development test, which would evaluate a wholesale bank's record of making community development loans, investments, and services, either directly or indirectly, through an entity such as a CDFI.¹⁵¹ Supporting CDFIs through loans, investments, and services would not only earn CRA credit for retail and wholesale banks, it would probably earn extra credit because such loans or investments would be particularly complex, innovative, and responsive to community needs.¹⁵²

The CDFI Act created a \$382 million "Community Development Financial Institutions Fund" (the "Fund") to provide financial support in the form of matching loans, investments, grants, and deposits to CDFIs.¹⁵³ The maximum amount any CDFI can receive from the Fund is \$5 million over any three year period.¹⁵⁴ Assistance from the Fund must be matched dollar for dollar with non-government sources.¹⁵⁵ The Fund can provide financial assistance in

¹⁴⁹ Pub. L. No. 103-324, tit. I, 108 Stat. 2160 (1994).

¹⁵⁰ 12 C.F.R. §§ 25.22(b)(4), 25.23(e), and 25.24. Community development lending is one of four criteria under the "lending test," which would be the most important test in determining a retail bank's CRA record. 12 C.F.R. § 25.22(b)(4). Community development investment is a secondary basis for a retail bank's CRA rating. 12 C.F.R. § 25.23(e). Finally, community development services is one of the criteria under the "services" test, another secondary basis for a retail bank's CRA rating. 12 C.F.R. § 25.24.

¹⁵¹ 12 C.F.R. § 25.25(c).

¹⁵² 12 C.F.R. §§ 25.22(b)(4), 25.23(e)(2), and 25.25(c)(2).

¹⁵³ Pub. L. No. 103-324, §§ 102(B)(2) and 121(a), 108 Stat. 2160 (1994).

¹⁵⁴ *Id.* at § 108(D).

¹⁵⁵ *Id.* at § 108(E). *But see* § 108(E)(2) (noting that exceptions to the dollar matching requirement may be permitted by the fund in the case of an applicant with severe constraints on available sources of matching funds).

several forms, including equity investments, deposits, credit union shares, loans, and grants.¹⁵⁶

The CDFI Act defines a CDFI as an institution that: 1) has a primary mission of promoting community development; 2) serves either an economically distressed geographical area or a needy group of individuals; 3) provides development services such as business planning or financial and credit counseling in conjunction with providing equity investment and loans; and 4) is accountable to residents of its geographical area or to its target population.¹⁵⁷

The Fund will be a wholly owned government corporation managed by a presidentially-appointed administrator.¹⁵⁸ Applicants for financial assistance must be CDFIs.¹⁵⁹ Among the criteria the Fund will consider when evaluating applications for assistance are the extent of need and economic distress in the geographic area or population to be served by the CDFI, the extent to which the matching funds are from private sources, and the extent to which the applicant is community-owned or governed.¹⁶⁰ The CDFI Act requires the Fund to ensure that CDFIs receiving financial assistance are financially sound.¹⁶¹

CDFIs can use funds received pursuant to the CDFI Act to support the following: 1) commercial facilities that promote revitalization, community stability, or job creation and retention; 2) businesses that provide jobs, are used by or enhance the availability of, products and services to low-income people; 3) community facilities; 4) provision of basic financial services; and 5) housing that is principally affordable to low-income people.¹⁶²

¹⁵⁶ *Id.* at § 108(a).

¹⁵⁷ *Id.* at § 103(5)(A)(I-IV), 103(10), 103(20).

¹⁵⁸ Pub. L. No. 103-324, § 104(a)(2), 108 Stat. 2160 (1994).

¹⁵⁹ *Id.* at § 105(B).

¹⁶⁰ *Id.* at § 107(A).

¹⁶¹ *Id.* at § 108(F).

¹⁶² *Id.* at § 108(B).

IV. Conclusion

Community groups have used the CRA to help eliminate poverty by forcing banks to funnel billions of dollars in loans to low-income communities. Nevertheless, due to limits in the scope of the CRA and HMDA, the government's underenforcement of the laws, and the dependency that this creates on outside institutions, this approach to using the CRA and HMDA to fight poverty has significant limits. One way that community groups have been improving the effectiveness of the CRA and HMDA as poverty-fighting tools is by using them to strengthen CDFIs. Unlike banks, these institutions are community-controlled institutions dedicated to community economic development. If government support for CDFIs continues to grow, this will facilitate efforts to develop CDFIs and go a long way toward maximizing the potential of the CRA and HMDA as tools to promote economic development and community empowerment and to fight poverty.

