NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

Testimony

of

James H. Carr

Chief Operating Officer
National Community Reinvestment Coalition

Before the

United States House of Representatives
Subcommittee on Domestic Policy of the
Committee on Oversight and Government Reform

Washington, DC

Wednesday, October 24, 2007
2154 Rayburn Building
2:00

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Introduction

Good afternoon, Mr. Chairman and Members of the Committee. My name is James H. Carr and I am the Chief Operating Officer of the National Community Reinvestment Coalition (NCRC). I am honored to speak with you today on behalf of NCRC and its 600 community nonprofit member organizations, that are dedicated to increasing access to credit and capital, for low and moderate income and minority working families and communities.

We are pleased that you are conducting this hearing on the effectiveness of the Community Reinvestment Act (CRA) and the appropriate role of public participation in the CRA process. By establishing an affirmative and continuing obligation upon banks to serve their communities, CRA has leveraged a tremendous amount of credit and capital for traditionally underserved communities. NCRC calculates that banks have made CRA-related commitments to issue more than $4.6 trillion of loans and investments in minority and low- and moderate-income communities since CRA's enactment in 1977.[1] The success of CRA has been documented in research published by a range of respected research institutions and federal agencies including the Federal Reserve Bank, Treasury Department and Harvard University to name a few. Their conclusion is that CRA has increased safe and sound lending to minority and low- and moderate-income borrowers and communities.[2]

Yet, the full potential of CRA has not been realized. Three areas of weaknesses can be identified as contributing to the current shortcomings of the potential of CRA. They include: regulatory enforcement has not been consistent over time or geography, regulatory oversight has not kept pace with the changing financial services marketplace; and the reach of CRA is not sufficient relative to its stated goals. I will highlight six recommendations that, if enacted, could greatly enhance the effectiveness of CRA to increase greatly access to credit and capital in low and moderate and minority working communities across the nation.:

- Make mandatory the inclusion of a bank's non-depository lending affiliates and subsidiaries in CRA exams.

- Reform bank examination assessment area procedures so that the majority of a bank's loans are included in its CRA exams.

[1] NCRC's *CRA Commitments*, via http://www.ncrc.org/policy/cra/CRA%20Commitments%2007.pdf.
[2] The Joint Center for Housing Studies at Harvard University, *The 25th Anniversary of the Community Reinvestment Act: Access to Capitol in an Evolving Financial Services System*, March 2002; Robert Litan, Nicolas Retsinas, Eric Belsky and Susan White Haag, *The Community Reinvestment Act After Financial Modernization: A Baseline Report*, produced for the United States Department of the Treasury, April 2000; *The Performance and Profitability of CRA-Related Lending*, Report by the Board of Governors of the Federal Reserve System, July 17, 2000; Raphael Bostic and Breck Robinson, *Do CRA Agreements Influence Lending Patterns?* July 2002, available via bostic@usc.edu.

- Require regulatory agencies to provide detailed descriptions of fair lending and safety and soundness reviews conducted as part of CRA exams.

- Require that regulators give banks failing CRA performance reviews when fair lending reviews uncover widespread discrimination at those institutions.

- Require CRA exams to examine lending and services to minority borrowers and communities.

- Require that regulatory agencies hold hearings upon request by community representatives, to address major bank business decisions or changes such as mergers and acquisitions.

- Require all banks and thrifts to submit CRA small business loan data indicating race, gender, and location of the borrower.

- Extend CRA coverage to credit unions and independent mortgage companies.

Review of Recommendations

Mandatory Inclusion of Non-Depository Lending Affiliates

One significant shortcoming of CRA regulation has been the regulatory practice of allowing banks and thrifts to choose whether to include their non-depository affiliates on CRA exams. Banks can evade accountability and effectively engage in redlining and other discriminatory practices by choosing not to include affiliates on their CRA exams. Not surprisingly, affiliates excluded from CRA exams often exhibit less success in lending to minorities and low- and moderate-income borrowers and communities than their depository counterparts.

The lack of CRA coverage, and its associated tighter regulatory reviews and public accountability, invites a greater opportunity for lending institutions to violate fair lending laws. In 2007, NCRC identified 35 lending institutions engaged in practices that include refusal to make loans under a minimum loan amount (usually $75,000 or $100,000), refusal to make loans to row homes, or even failing to offer loans to entire cities (including Baltimore and Philadelphia). In other cases, lending institutions will make loans but charge higher interest rates that are not justified by legitimate business necessity. Out of the 35 lending institutions that engaged in discriminatory practices, 26 were independent mortgage companies outside the scope of CRA. Of the institutions found to be engaging in redlining or other exclusionary practices, four were non-bank affiliates that were not included on their affiliated bank's CRA examinations.

NCRC has demonstrated that these policies violate the Fair Housing Act by disproportionately impacting minorities and other protected classes. NCRC has filed several fair housing complaints with the Department of Housing and Urban Development and with federal court.

Reforming Assessment Area Procedures

NCRC's fair lending investigations have shown that inadequate procedures regarding the designation of assessment areas or geographical areas on CRA exams may encourage discriminatory policies. Under the current CRA regulations, assessment areas generally consist of geographical areas that contain bank branches. A significant number of lenders, however, are making loans in areas beyond their bank branches. In fact, financial institutions identified by NCRC's fair lending investigations have made significant amounts of loans through brokers in geographical areas beyond their bank branches. In one study, only 11% to 13% of the loans of four banks investigated by NCRC were in the banks' assessment areas.

Occasionally, the federal agencies will review a sample of loans outside the assessment areas to determine if lending performance outside assessment areas is consistent with performance inside the assessment areas.[3] But the agencies sampled loans outside the assessment areas for only one of the four banks we investigated in our study. With the great majority of lending activity outside of CRA exam review, it is not surprising to find more exclusionary lending practices at those institutions.

Providing Examination Descriptions

A major regulatory weakness that undermines CRA accountability and enforcement is the recent practice of providing to the public only cursory descriptions of the fair lending aspects of CRA examinations. The great majority of these reviews state in one to three sentences that no evidence of illegal or other discriminatory practices were found by the agencies. In contrast, the CRA exams in the 1990's described statistical tests conducted to probe for discriminatory lending. A cursory description of fair lending reviews decreases public confidence in the rigor of fair lending reviews and inhibits the public from effectively probing the types of anti-discrimination investigations undertaken by the agencies.

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. Unfortunately, there is no evidence to believe 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 one to three sentences that the regulatory agency tested for evidence of illegal and

[3] The reviews of lending outside of assessment areas generally have not been satisfactory. The sample of loans usually consists of a minority of a bank's total loans. Also, the examiner typically issues vague conclusions such as lending outside the assessment area is consistent with lending inside the assessment area. The general public does not know what would happen if an examiner found that lending performance outside the assessment area was inconsistent with lending performance inside the assessment area. NCRC has not encountered a CRA exam in which performance outside the assessment area was inconsistent with performance inside the assessment area.

discriminatory lending and that no such lending was found.[4] There is no discussion of what precisely had been done to reach this conclusion. Meanwhile, excessive high-cost lending pervades financially vulnerable communities, compounding their financial challenges, and making access to the financial services mainstream more difficult.

In one instance, NCRC examined a thrift that specialized in subprime lending. The CRA exam report for that that thrift noted that it issued a high percentage of loans to low- and moderate-income borrowers. The CRA fair lending review, however, did not describe if the examiner made any efforts to determine if the subprime lending was conducted in a non-discriminatory manner or was consistent with safety and soundness. 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.

Fair lending reviews could be more valid if the federal agencies described to the public what types of fair lending reviews they conducted. For example, the agencies could explain if they probe for race or gender discrimination, or if they scrutinize loans for evidence of flipping or steering. In addition, if the fair lending reviews were sufficiently detailed, members of the general public could ask follow-up questions about whether the examiners considered other factors not mentioned in the fair lending reviews. Sufficiently detailed fair lending reviews would encourage substantive dialogue among lenders, CRA examiners, and the general public that could result in better fair lending enforcement and confidence that the spirit and letter of the law were enforced.

Providing more detailed descriptions of fair lending reviews should be straightforward. The agencies used to provide detailed descriptions in the fair lending section of CRA exams in the mid-1990's under the previous "assessment factor" format of CRA exams. For example, 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 in a CRA exam dated January 1996 of Signet Bank. The exam also described regression analysis, which sought to determine if 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. Ironically, it was after the CRA regulations were reformed during the mid-1990s in an effort to improve the rigor of the exams that these descriptions of fair lending reviews disappeared from the CRA exams.

Moreover, although the spirit and letter of the law of CRA is to require banks to serve the communities in which they are located, findings of fair housing violations, as well as other

[4] For example, a federal agency had this to say on the CRA exam's fair lending review of one large bank with several affiliates, a number of whom 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.
[6] The Gramm-Leach-Bliley Act instituted the "have and maintain" passing rating requirement.

obvious and egregious CRA violations, are sometimes not sufficient to preclude banks' receiving a passing CRA grade. All of the banks mentioned above, found to pursue redlining practices, have inadequate assessment areas, and that had affiliates excluded from CRA exams, passed their CRA exams. In these cases, the CRA grade inflation has removed incentives for the banks to end these egregious practices.

Raising the Bar on CRA Passing Grades

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. 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.

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. When a lender has identified an outlier branch manager or loan offer that practiced discrimination, it may be appropriate for the regulatory agency to allow the bank to take immediate action. In this case, a lower CRA rating may not have been justified due to the localized nature of the action and the fact it may be immediately eradicated.

When, however, a practice is institutionalized in underwriting criteria, it is necessary to enforce a failed CRA rating. Discriminatory underwriting, including prohibiting loans to row homes redlines entire communities. It is ineffective and insufficient to rely on the banks promise 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.[6] The punishment can be removed at the time of the next CRA exam, provided that the bank can undergo a thorough fair lending review and demonstrate that it has eradicated all discriminatory practices.

Another instrumental reform is examining a bank's lending performance to minorities in CRA exams similar to their lending performance to low- and moderate-income borrowers. Given the evidence of glaring lending disparities by race, NCRC has long called for CRA exams to explicitly examine lending and services to minority borrowers and communities.[7] Before the CRA regulatory reforms in the mid-1990's, CRA exams under Assessment Factor D would often use HMDA data to assess performance of lending to minorities similar to the approach employed in the Signet examination discussed above. This practice should be reinstated and

[7] NCRC's HMDA studies show that differences to lending by race have persisted over several years. We also show that disparities in branching by race of neighborhood is greater than by income level of neighborhoods. See NCRC's *Income is No Shield against Racial Differences in Lending* via http://www.ncrc.org/pressandpubs/documents/NCRC%20metro%20study%20race%20and%20income%20disparity%20July%2007.pdf, and *Are Banks on the Map* via http://www.ncrc.org/pressandpubs/documents/NCRCAreBanksontheMap.pdf

expanded given the reality that lending differences by race/ethnicity remain stubborn, persistent and significant.

Sharing Safety and Soundness Examination Findings

Despite CRA mandates that credit needs are to be met consistent with safety and soundness, there are no results in the CRA exams on this topic. Given current public policy concerns about predatory lending and foreclosures, the significance of this regulatory weakness cannot be overstated.

Holding Public Meetings and Hearings

CRA's effectiveness depends on the level of public accountability it establishes. Public hearings are the mechanism through which communities share their needs and perspectives with banks. Federal agencies also gain detailed and valuable information during the hearing process. Failure to hold public hearings therefore undermines community input and by extension, the effectiveness of CRA. Over the last several years, the federal agencies have dramatically decreased the number of public hearings, particularly in the case of merger applications. In fact, 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 merger 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 when the merger clearly had ramifications for the recovery of the Gulf States. 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.[11]

In some cases, mergers result in the possible closures of hundreds of branches, particularly for banks with overlapping markets. In other cases, merged institution may not be as responsive to community needs and projects. Sometimes, the bank being acquired has a decentralized and flexible means of engaging in community development lending and investing that facilitates

[11] Bank of New York received a low satisfactory on its lending and service test from the Federal Reserve Bank of New York on both its 2005 and 2003 CRA exams. In other words, the bank was close to failing on two CRA exams in succession. Yet, no public hearing on the merger occurred.

neighborhood-level housing and economic development initiatives. In contrast, the acquiring bank might have a centralized process that may not be as responsive. Finally, the focus in some mergers will be on fair lending and safety and soundness concerns related to high-cost and/or exotic mortgage lending.

Federal regulatory agencies rarely deny merger applications. Occasionally, they will approve the merger subject to specific conditions for improved CRA and fair lending performance or procedures. In other cases, regulatory agencies will convene hearings and meetings in an effort to encourage voluntary solutions worked out between lending institutions and community organizations. When bank merger applications involve public hearings or meetings, banks and community groups are more likely to negotiate CRA agreements.[12] CRA agreements are promises made by banks to make specified amounts of loans and investments to low- and moderate-income and minority working communities over a specified period of time period (see NCRC's publication *CRA Commitments*).[13]

Agreements also often contain considerable detail on carefully constructed products for minority and low- and moderate-income borrowers. For example, home mortgage products can include lower closing costs, waiver of private mortgage insurance, counseling requirements, and the establishment of Individual Development Accounts (IDAs) to help pay for down payments. Likewise, small business products may offer lower interest rates in exchange for small business owners receiving counseling. The small business products also feature lower loan sizes needed by the smallest businesses and are often provided to minority or women-owned small businesses. In contrast, when CRA agreements are not negotiated and banks announce unilateral commitments, there is little assurance that the commitments relate to the actual needs of the community as defined by residents of those areas.

In testimony before this committee earlier this year, an official representing the Federal Reserve Board (FRB) testified that the FRB has held only 13 public meetings since 1990 on mergers. This is less than one meeting per year in an era in which consolidations have changed profoundly the banking industry. In addition, the FRB representative 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 8 of these denials involving consumer protection or community needs issues.[14]

In the fall of 1999, major banking reforms were included in the Gramm-Leach-Bliley (GLB) Act that compounded some of these issues. In addition to permitting banks to merge with insurance companies and securities firms, the GLB Act allowed bank holding companies to acquire non-bank lending institutions without submitting an application subject to public comment on CRA

[12] CRA agreements are not required by the CRA statute or regulation, but substantive CRA agreements become more likely when regulatory agencies convene public meetings and hearings.
[13] NCRC's *CRA Commitments*, via http://www.ncrc.org/policy/cra/CRA%20Commitments%2007.pdf
[14] See http://www.federalreserve.gov/newsevents/testimony/braunstein20070521a.htm for Ms. Braunstein's testimony.

grounds. GLB also did not eliminate the optional inclusion of affiliates on CRA exams or fix assessment area procedures so that assessment areas would be required to cover the great majority of a bank's lending activities.

Inasmuch as GLB granted banks considerable new powers and expanded their markets, it would seem logical that GLB would also have ensured that the larger and more powerful banks would have enhanced requirements to serve their communities. Unfortunately, while GLB boosted the size and power of banks, it did not boost their obligations to their communities. Instead, GLB established a regulatory oversight system that undermines the intent of CRA to require banks to serve their communities through lending, investment, and service activities. As NCRC's case studies show, banks now can grow and evade CRA and fair lending responsibilities by placing lending activities in affiliates and making larger numbers of loans outside of assessment areas.

The weaknesses introduced into CRA by GLB have been recognized by various Members of Congress. Representatives Luis Gutierrez and Thomas Barrett, for example, introduced legislation (CRA Modernization Act in 2000 and 2001) that would have required inclusion of affiliates and would have fixed assessment area procedures so that the great majority of loans would be included in CRA exams. More recently, similar provisions were included in a bill offered by Representatives Eddie Bernice Johnson and Luis Gutierrez referred to as The CRA Modernization Act of 2007 or HR 1289. Unfortunately, problems exacerbated by GLB remain. They hamper effective enforcement of CRA. In the process, they undermine access to banking services to millions of hard-working and deserving families.

The Office of Thrift Supervision (OTS) used to require the holding of a meeting between merging thrifts and community groups when such a meeting was requested by a community group that had requested a meeting and submitted written comments pertaining to the merger. This procedure should be implemented by all the agencies. Meetings, as distinguished from public hearings, usually involve relatively small number of stakeholders, including regulatory officials, a few community leaders, and representatives of the merging institutions. These meetings are easy to convene and 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 involved than meetings in that several community groups, citizens, elected officials, and others testify. 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 so that the officials can understand the gravity of the situation and the importance of the banks to the affected communities.

Extending CRA Coverage

CRA coverage should be extended to credit unions; NCRC studies have found that non-CRA covered credit unions provide a lower percentage of their loans to minorities and low- and

moderate-income borrowers and communities than do banks.[15] CRA should also apply to independent mortgage companies; NCRC has uncovered several mortgage companies engaged in redlining and other discriminatory practices. The CRA Modernization Act would also require merger applications when banks seek to acquire mortgage companies and other non-depository institutions.

Providing Increased Data on Small Business Lending

CRA small business loan data should be submitted by all banks and thrifts and should include the race and gender of the small business borrower. Small business loans are critical to the overall flow of capital in communities and the lack of this important financial service can undermine an otherwise positive engagement of banks in low and moderate income and minority communities. Moreover, inasmuch as major disparities in lending to minorities exist in the small business loan market, similar to those in the home mortgage market, data on this lending should include key demographic data on the borrowers.

Conclusion and Recommendations

As we celebrate the 30th anniversary of CRA, it is useful to look back as well as forward. Looking back, we see a law that has stimulated the flow of billions of dollars each year to lower-income and minority communities to expand homeownership and promote healthy communities. Looking back we also see, however, major areas of weakness in the law and concomitantly, areas for improvement in the flow of capital and credit to families and businesses that need it the most. The recommendations we make today, if enacted, would greatly promote the goal of CRA to improve the flow of capital and credit to communities. Those recommendations include requiring broader coverage of a bank's activities in CRA examinations; enhanced disclosure of the details of fair lending and safety and soundness examinations; more rigorous standards to receive passing CRA grades, particularly in the case of fair lending violations; more specific examination of lending performance and practices to minority consumers; more public meetings and hearings on bank mergers and related major business events; and extension of CRA to credit unions and independent mortgage companies.

Many of the ideas we recommend today are included in The CRA Modernization Act of 2007 (H.R. 1289) and we encourage its passage. Improving access to the financial mainstream is important to the families and businesses, the communities in which they reside or operate, and the nation as a whole. We applaud the work of this Committee and look forward to continuing to work with you on this important issue.

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[15] See NCRC's *Credit Unions: True to their Mission* via http://www.ncrc.org/policy/states/cu_report2.php