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Domestic Policy Subcommittee of the
Oversight and Government Reform Committee
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2154 Rayburn HOB – 2:00 P.M.

Thank you for the opportunity to testify this afternoon. This Committee=s hearing, AUpholding the spirit of the CRA: Do CRA ratings accurately reflect bank lending practices?,@ is especially timely as this year marks the thirtieth anniversary of the CRA=s passage. As we reflect on the role the CRA has played in its thirty years, it is clear that while the CRA has influenced banks to make more loans in underserved communities, there is room for improvement. Community groups have played a significant role in enforcing the CRA, but their efforts have been undermined by agency discretion in enforcing the CRA as well as the agencies= failure to evaluate bank lending according to race when conducting CRA performance evaluations.

In my testimony, I will address four issues:

1. the intended role of community groups in CRA enforcement;
2. the impact of regulatory discretion on community group CRA enforcement;
3. the agencies= failure to consider lending by race when conducting CRA performance evaluations; and
4. the role community groups can play in working with banks to end lending discrimination.

The Intended Role of Community Groups in the CRA

The intended role of community groups in the CRA is to help enforce the law by acting as watchdogs over bank lending practices, meeting with banks and the federal banking regulatory agencies (the

Aagencies@) to highlight bank successes and failures at meeting community credit needs, and filing administrative challenges to bank expansion applications with the agencies on the grounds that the banks have not met their CRA obligations. In essence, community groups are private attorneys general under the CRA and their Aenforcement from below@ has influenced banks to increase their lending to underserved neighborhoods.

By giving this role to community groups, the CRA has Ademocratized capital."[1] The CRA has democratized decisions about the distribution of capital by extending at least part of the decision-making Afranchise@ to previously Adisenfranchised@ people. Community groups have used this franchise, in turn, to influence banks to make billions--if not trillions--of dollars of loans to people who might not otherwise have received them, allowing the recipients to participate in the economic mainstream, further democratizing the economy.

The Legal Structure of the CRA

The seeds for democratizing capital are contained in the legal structure of the CRA. The CRA imposes on banks a Acontinuing and affirmative obligation to help meet the credit needs of the local communities in which they are chartered,@ including low- and moderate-income (ALMI@) neighborhoods.[2] The CRA requires the agencies to enforce bank obligations to meet community credit needs.[3]

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[1]*See Richard Marsico*, DEMOCRATIZING CAPITAL: THE HISTORY, LAW, AND REFORM OF THE COMMUNITY REINVESTMENT ACT 3-4 (2005).

[2]12 U.S.C. ' 2901(a)(1) and (3)(2000).

[3]The agencies and the banks they regulate are the Comptroller of the Currency (national banks); Board of Governors of the Federal Reserve System (state chartered banks which are members of the Federal Reserve System and bank holding companies); Federal Deposit Insurance

The CRA requires the agencies to enforce the CRA in two different ways. First, it requires each agency to examine periodically each bank it regulates to determine whether the bank is helping to meet community credit needs and to issue a written public evaluation report--including a rating--evaluating the bank=s CRA performance.[4] Second, the agency must take a bank=s CRA record into account when considering certain bank expansion applications.[5]

The agency that receives the application has the power to grant it (which happens the overwhelming majority of the time), deny it (which happens very rarely), or condition it on improved CRA performance (which happened with some frequency in earlier years, but less frequently now).[6]

The Impact of CRA Challenges

When a bank files an expansion application, any member of the public may file comments opposing the application on the grounds that the bank has failed to meet its CRA obligation with the agency that

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Corporation (state chartered banks and savings banks which are not members of the Federal Reserve System); and Office of Thrift Supervision (savings associations and savings and loan holding companies). 12 U.S.C. '2902(1).

[4]12 U.S.C. ''2903(a)(1), 2906.

[5]The applications subject to the CRA are applications for a charter for a national bank or federal savings and loan association; for deposit insurance for a newly chartered bank; to open a branch; to relocate the home office or a branch office; to merge or consolidate with, or to acquire the assets or assume the liabilities of, a bank; and to become or merge with a bank holding company. 12 U.S.C. ' 2903(a)(2)-(3).

[6]*See, e.g.*, 12 C.F.R. '228.29(c)(2007).

regulates the bank (known as a ACRA challenge@).[7] Community groups, on behalf of LMI neighborhoods and predominantly minority neighborhoods, have frequently filed such challenges.

The seeds for democratizing capital planted in the CRA have borne fruit. The opportunity for community groups to file CRA challenges to expansion applications has given them a significant voice in decisions about the distribution of loans. Banks fear CRA challenges for several reasons: there is there is a chance--however slight--that the challenge could be upheld and the application denied; the challenge could delay the regulatory approval process and either make the merger less attractive financially or cause it to fall through; a challenge could be costly and time-consuming; or a challenge could result in bad publicity.[8]

Banks feel pressure either to avoid challenges or to resolve them once filed. The most common way for banks to avoid or resolve challenges is by entering into lending agreements with community groups (known as ACRA agreements@) or issuing unilateral CRA commitments.[9] These CRA agreements and commitments share several common features, most significantly a commitment to lend a specific dollar amount of a particular type of loan or loans (for example, affordable housing and small business loans) to a particular neighborhood or to individuals with specified characteristics, over a specified time period.[10] The National Community Reinvestment Coalition has estimated that between 1977 when the CRA was passed and 2005, banks entered into CRA agreements or issued unilateral commitments promising $4.2 trillion in loans to

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[7] *Id.*, at ' 228.29(b).

[8] *See Marsico, supra* note 1, at 133.

[9] *Id.*

[10] *See Marsico, supra* note 1, at 135.

underserved communities.[11]

The Effect of Regulatory Discretion on the Effectiveness of Community Group CRA Enforcement

[11]NATIONAL COMMUNITY REINVESTMENT COALITION, CRA COMMITMENTS 1 (Summer 2005).

Both the CRA statute[12] and the federal banking regulatory agencies= CRA regulations[13] give the agencies broad discretion in enforcing the CRA. Although the statute places an affirmative obligation on banks to meet the credit needs of their communities and requires the agencies to enforce this obligation, the statute does not establish performance standards or other criteria with which to evaluate a bank=s performance. Similarly, although the CRA regulations establish tests for evaluating CRA compliance and specify several criteria the agencies are to examine, including lending, investment, and banking services, the regulations do not establish benchmarks against which to measure a bank=s CRA performance. The agencies have chosen to exercise their discretion in a way that undermines the democratizing tendency of the CRA and the ability of community groups to enforce the law. When they evaluate banks and decide bank expansion applications they do not use consistent or objective standards and they do not enforce the law strictly. In the absence of definite standards to measure bank lending performance and strict enforcement, it is difficult for community groups to hold banks accountable for poor lending records.

CRA Performance Evaluations

My study of a sample of CRA performance evaluations (ACRA PEs@) the agencies issued between 1997 and 2001 reached several conclusions about how the agencies conducted CRA PEs and the extent of their discretion:

1. The agencies did not use a fixed set of criteria for evaluating bank lending.

[12]12 U.S.C. ''2901-2908 (2000).

[13]The agencies= CRA regulations appear at 12 C.F.R. pts. 25 (Comptroller of the Currency); 228 (Federal Reserve); 345 (Federal Deposit Insurance Corporation); and 563e (Office of Thrift Supervision)(2007).

2. The agencies used subjective and imprecise standards for evaluating bank lending.
3. The agencies did not define the level of lending necessary to satisfy the lending criteria they used.
4. The agencies did not define the weight of the criteria they used.
5. The agencies often evaluated similar performances by different banks on the same criteria differently.
6. The agencies frequently gave banks higher ratings than they deserved based on bank performance pursuant to the criteria the agencies used to evaluate their performance.[14]

The agencies also exercised their discretion to give high CRA ratings to banks. Each year from 1997 to 2003, the federal banking agencies gave satisfactory CRA ratings to between 97.1% and 98.9% of banks they evaluated.[15]

Decisions on Expansion Applications

My study of more than 100 written decisions on bank expansion applications that considered the bank=s CRA record that the Federal Reserve or Comptroller of the Currency issued between 1997 and 2003 found many similarities between how the agencies evaluated bank lending in CRA PEs and how they evaluated lending when considering expansion applications.[16] The decisions did not use a fixed set of criteria for evaluating bank lending and they used subjective terms when applying the criteria. The decisions generally listed facts about the bank=s lending, emphasized strengths and excused weaknesses, and did not disclose the

[14]*See Marsico, supra* note 1, at 90-106. I have reviewed many CRA PEs issued in recent years and do not see any reason to change these conclusions.

[15]*See Marsico, supra* note 1, at 130. The four possible CRA ratings are outstanding, satisfactory, needs to improve, and substantial non-compliance. *Id.*, at 83.

[16]*See Marsico, supra* note 1, at 107-113.

reasoning they used in reaching their decisions. Often, the decisions acknowledged the accuracy of critical public comments about bank lending but nevertheless granted the application without further comment.

The Agencies= Failure to Consider Lending by Race in CRA Performance Evaluations

When conducting CRA PEs, the agencies do not evaluate lending by the race of the borrower or by the racial composition of the neighborhood. They do not consider the number or dollar value of loans to African-Americans, Latinos, or predominantly minority neighborhoods. They do not consider the percentage of the bank=s loans to these groups compared with the percentages of loans to these groups by all lenders in the aggregate. Instead, they consider the results of a separate fair lending examination of the bank and take that examination into account when giving a bank its CRA rating.[17] A poor result on the bank=s fair lending examination, however, does not mandate a failing CRA rating.

The agencies= justification for not considering lending by race in CRA PEs is that the language of the CRA addresses lending according to income, not race.[18] This explanation is untenable. The CRA=s legislative history shows that Congress intended the CRA to eliminate redlining based on race as well as income.[19] Although the CRA explicitly requires a bank to meet the credit needs of its entire community, including LMI neighborhoods, this language does not prohibit the agencies from considering lending to other communities, especially in light of Congress= intent to eliminate racial redlining.

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[17] *See, e.g.*, 12 C.F.R. ' 25.28(c)(2007).

[18] *See Marsico, supra* note 1, at 178.

[19] *See Marsico, supra* note 1, at 90.

The Value of Community Participation in the Process of Rectifying a Bank=s Discriminatory Practices

Bank discriminatory practices can take many different forms, including redlining, reverse redlining, disparate treatment, and disparate impact. There are two significant ways community groups can play a role in rectifying these. First, they can gather and publicize data about bank lending patterns. Second, they can enter into agreements with banks, similar to the CRA agreements described above, that contain provisions that will help end a bank=s discriminatory lending practices. This role is consistent with the intended role for community groups in the CRA enforcement process, but is undermined by regulatory discretion in enforcing the CRA and the agencies' failure to consider lending by race in their CRA PEs.

Discriminatory Practices

The following is a non-exhaustive list of discriminatory lending practices:

1. Redlining: Redlining is the practice of refusing to lend in a community because of characteristics of the neighborhood--such as the income level or race or ethnicity of its residents--that are unrelated to the creditworthiness of particular borrowers in the neighborhood.

2. Reverse Redlining: This type of discrimination is the opposite of redlining. Instead of refusing to lend in particular neighborhoods because of the racial composition of the neighborhoods, banks and other lenders target predominantly minority neighborhoods for higher-price subprime loans.

3. Disparate treatment: Lenders practicing this type of

discrimination treat minority loan applicants less favorably than white loan applicants because of their race. An example of disparate treatment occurs when a lender grants a loan to a white person but denies a loan to a similarly situated minority person. Another example is when a lender charges a higher interest rate to a minority person than a similarly situated white person.

4. Disparate impact: Lenders practicing this type of discrimination employ policies or practices that are not discriminatory on their face but have a disproportionately negative impact on persons or communities of color. For example, a lender=s policy that it will not make a loan for less than a certain threshold amount might have a disparate impact if property values in predominantly minority neighborhoods are lower that property values in predominantly white neighborhoods.

Rectifying Lending Discrimination Through Gathering and Publicizing Information

Community groups have played an important role in rectifying lending discrimination by gathering and publicizing data about bank lending made available by the Home Mortgage Disclosure Act (AHMDA@)[20] that shows that banks treat white applicants and minority applicants differently. This publicity led to strengthened enforcement of the CRA and the Fair Housing Act (AFHA@) and subsequently to increased lending in underserved neighborhoods.

In 1991, the Federal Reserve released HMDA data that for the first time contained information about the race of home mortgage loan applicants and the racial composition of the neighborhoods in which the property that was the subject of the loan application was located. The data showed that, nationally, lenders rejected home mortgage loan applications

[20]12 U.S.C. ''2801-2810 (2000).

from African-Americans more than twice as frequently as loan applications from whites, from Latinos approximately 1.4 times more frequently as loan application from whites, and for loans to purchase property located in predominantly minority neighborhoods more than twice as frequently as applications to purchase property located in predominantly white neighborhoods.[21] Community groups, newspaper reporters, national advocacy groups, and scholars issued studies about this data that confirmed it on the national and local levels.[22]

Using the data, community groups increased their CRA advocacy efforts and pressured the federal banking regulatory agencies to improve their enforcement of the CRA and the Department of Justice (ADOJ@) to enforce the Fair Housing Act (AFHA@).[23] The government agencies responded; the banking regulators strengthened the CRA regulations and tightened their enforcement and the DOJ brought several lending discrimination cases, the first cases they had brought against lenders under the FHA.[24]

These efforts were successful. By 1997, the national market share of conventional home mortgage loan approvals to African-Americans, Latinos, and predominantly minority neighborhoods stood at 5.6%, 5.0%, and 2.6%.[25] These levels represented increases from their 1991 levels of

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[21]Glenn B. Canner & Dolores S. Smith, *Home Mortgage Disclosure Act: Expanded Data on Residential Lending*, 77 FED. RES. BULL. 859, 870, tbl. 5 (1991).

[22]For examples of such studies, *see Marsico*, supra note 1, at 168, n.114.

[23]Richard Marsico, *Shedding Some Light on Lending: The Effect of Expanded Disclosure Laws on Home Mortgage Marketing, Lending, and Discrimination in the New York Metropolitan Area*, 27 FORD. URB. L.J. 481, 499-511 (1999).

[24]*Id.*

[25]*Id.*, at 499.

80.6%, 21.9%, and 36.8%, respectively.[26]

Agreements between Community Groups and Banks to End Discriminatory Lending Practices

As described above, community groups have traditionally entered into agreements with banks designed to redress weaknesses in their CRA lending records. Many of these agreements also contain provisions that will help rectify discriminatory lending practices. There is no reason that community groups and banks cannot enter into similar agreements to help end lending discrimination. In such an agreement, a bank might agree to:[27]

1. Make a specific dollar amount of home mortgage loans in predominantly minority neighborhoods or to minority borrowers.[28]
2. Offer affordable home mortgage loan terms and conditions, including
    a. lower-interest rates;
    b. no minimum loan size;
    c. reduced points;
    d. reduced downpayment amounts; and
    e. waived mortgage insurance.[29]
3. Utilize flexible underwriting standards, including standards relating to
    a. Credit history, including allowing loan applicants to explain credit problems;
    b. Employment history, including substituting the

[26] *Id.*

[27] These examples are from CRA COMMITMENTS, *supra* note 11.

[28] *Id.* at 16-22.

[29] *Id.* at 22-26.

requirement that an applicant work at the same job for two years for a requirement that the employee work continuously for two years;

c. Income source, including counting as income social security, public assistance, unemployment benefits, and income from self-employment and part-time employment;

d. Mortgage debt/income and overall debt/income ratios --increasing the ratios from the traditional 28%/36% to, for example, 33%/40%; and

e. Property appraisal, including employing minority appraisers.[30]

4. Pay community groups to provide home loan counseling to potential borrowers.[31]

5. Conduct a Asecond review@ of rejected loan applications from minority borrowers.[32]

6. Conduct lending discrimination testing.[33]

Conclusion

Community groups have an important role in CRA enforcement. Their role has been weakened by agency discretion in enforcing the CRA and the agencies' failure to consider lending by race when conducting CRA PEs. Limiting agency discretion and requiring them to consider lending by race in CRA PEs could allow community groups to work more successfully to end lending discrimination.

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[30] *Id*. at 26-29.

[31] *Id*. at 32.

[32] *Id*. at 32-33.

[33] *Id*. at 33.