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SCHOOL OF LAW

Sept. 14, 2001

Dear Mr. Buck:

I understand that OTS will reevaluate the CRA regulations soon. Enclosed is a copy of an article discussing changes in the markets delivering banking services. I hope it is useful to you.

Sincerely,
Vincent Di Lorenzo

cc Askin, Robin, Bennett

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COMMENTARY

Community Reinvestment Act

Financial Services Modernization Provides an Opportunity for Increased Responsiveness to Community Needs

Vincent Di Lorenzo

Increasingly, legislators and market forces are eliminating barriers between banking and other financial or nonfinancial industries. These developments present opportunities for regulators and members of the banking community to better respond to the needs of low and moderate income communities. This article examines three aspects of the current evolution in financial services: participation in the lending market, sources of funds in the deposit market (including the emergence of Internet banking), and the legal environment. Some of these opportunities require legislators to take action, but others can be pursued directly by regulators.

Evolution of the Loan Marketplace

With the Community Reinvestment Act of 1977 (CRA), Congress sought to provide equal credit opportunity to all communities, including those in low and moderate income areas. Although regulators implementing the CRA have typically focused on equal opportunity for home mortgage loans, they have in recent years emphasized small business lending as well.

The CRA always has been limited in its coverage, extending only to insured depository institutions (referred to as CRA lenders).[1] In the past, such institutions dominated the home lending market, but by the 1990s other types of lenders had gained market share. In 1982, one category of non-CRA lenders, mortgage bankers, originated 28.9 percent of all mortgages on one- to four-family units. By 1994, their share of such loans increased to 52.8 percent,[2] a trend that has continued through the 1990s.[3]

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Some of this growth has come either because banks and thrifts have acquired independent mortgage companies or because loan origination activity has shifted to newly formed bank and thrift mortgage banking affiliates. The Department of Treasury's Baseline Report on the CRA indicates that between 1993 and 1998, two-thirds of all home purchase or refinancing loans were originated by CRA lenders or their affiliates, which include depository institutions and their subsidiary mortgage banks.[4] Currently, all such mortgage banks fall outside the reach of the CRA.

In small business lending, CRA lenders still dominate the market, though non-CRA lenders have obtained a substantial share. The 1993 National Survey of Small Business Finances revealed that banks and thrifts held 65.3 percent of all outstanding small business credit while other lenders held 34.7 percent.[5] Nonbank financial institutions, however, have aggressively entered the small business loan market in recent years.[6] The Consumer Bankers Association's 2000 Small Business Banking survey found nonbank competitors gaining in prominence—with American Express and Merrill Lynch named as likely top competitors within five years.[7] In addition, the Gramm-Leach-Bliley Act of 1999 (the GLBA) may increase nondepository institutions' share of the small business lending market.

The GLBA is also likely to further increase the number of home mortgages originated by non-CRA lenders. New firms that enter traditional banking markets and engage in home mortgage lending are likely to do so through a mortgage banking subsidiary. Though it is too early to know how financial holding companies will behave under the GLBA, nonbank firms' past activities offer some insights. For example, General Motors Acceptance Corporation won government approval to charter a thrift on April 20, 2000. GMAC Mortgage will be an operating subsidiary of the thrift, GMAC Bank, and will be one of the country's largest originators and servicers of residential mortgages and home equity loans. GMAC Bank will have one office (in Wilmington, Delaware) and GMAC Mortgage will operate approximately 170 retail branches.[8]

When debating the GLBA, Congress declined to extend the CRA to mortgage companies. As a result, low and moderate income communities may face greater challenges to their credit needs.

Although some researchers argue that mortgage companies are active in low and moderate income communities without the CRA legislative mandate,[9] the Treasury Department's Baseline Report, issued in April 2000, presents a more complex picture. It reveals that most loans to low and moderate income borrowers and neighborhoods were made by CRA lenders and their affiliates.[10] Admittedly, independent mortgage companies are making a substantial share of loans in low and moderate income communities, but the overwhelming majority of loans made by such lenders were subprime loans.[11] In other words, non-CRA lenders are seeking high profit lending opportunities in low income neighborhoods. From 1993 to 1998, CRA prime lenders and their affiliates increased their home purchase loan originations in low and moderate income communities by 47 percent, com-

pared with 30 percent for non-CRA prime lenders. Home refinance loans were 21 percent higher for CRA prime lenders and their affiliates, but down 12 percent for non-CRA prime lenders.[12]

Second, nonbank financial firms are choosing to offer a broad array of banking services, including insured deposits. For example, State Farm Insurance, through State Farm Bank, is offering checking accounts, savings accounts, certificate of deposit, and money market accounts, as well as home mortgage and home equity loans.[13] Merrill Lynch offers checking accounts, FDIC-insured cash management accounts, and loans and mortgages.[14] Paine Webber announced plans to offer insured deposits, as well as residential mortgages.[15] As nonbank firms enter the banking market, an even greater share of participants in the loan market will be CRA lenders or affiliates. CRA regulations permit depository institutions, at their option, to choose to have affiliate activities considered when regulators assess compliance with the CRA regulations' lending, service, and investment tests.[16] Thus, there is an incentive for CRA lending even when most or all lending activity is conducted by a mortgage bank affiliate of a depository institution. An example of increased responsiveness is Merrill Lynch's plan to commit $159 million in loans and outreach services for small businesses in Asian, Latino, and African-American areas in California.[17]

Increased CRA activity need not depend solely on legislative action, or on the "voluntary"efforts of greater numbers of CRA lenders and their affiliates. Additional regulatory action can address corporate structures in which loan entities are the subsidiary or affiliate of a depository institution, rather than the depository institution itself. The issue is, how much CRA activity is enough for a satisfactory CRA rating? The statute is silent on this point. Should a regulator consider only the size of the depository institution or should it also consider the size of subsidiary or affiliate corporates that offer home mortgages and loans to small businesses? Regulators have had differing views on this question.[18] CRA performance could be evaluated in light of the true size of the lending entity, including the size of subsidiaries and affiliates of the depository institution. This becomes increasingly desirable after enactment of the GLBA but is it permissible under existing law?

The CRA imposes obligations on an "insured depository institution."[19] Subsidiaries and affiliates[20] are distinct corporate entities that do not receive deposits. The real question becomes whether CRA evaluations should be based on the size of an institution's deposits or the overall capacity of an institution to make loans, whether funded by deposits or otherwise. The performance test under current CRA regulations depends on a bank's capacity.[21] Capacity is determined by available funds generated by deposits, by nondeposit sources, and by secondary market sales that multiply lending opportunities. If nondeposit sources and secondary market sales are handled in a subsidiary or affiliate, and they are excluded from calculations of capacity, a distorted assessment of the bank's true lending capacity may result. This partly justifies the Comptroller's view that assets and profit-

ability of bank subsidiaries should be considered when assessing the bank's capacity and ability to lend or invest in its community.[22]

Arguably, a bank's capacity would be greater if it conducted all lending in the bank rather than in a bank subsidiary. It is not certain, however, that an affiliate's lending capacity can be attributed fully to the bank. This is especially true in the post-GLBA era when the holding company may not be a bank holding company but a financial holding company, e.g., one whose main business is securities underwriting and sales or insurance underwriting and sales. Thus, Congress may need to clarify or amend the CRA.

Evolution of the Deposit Market

Current CRA regulations are based on a model in which deposits are received at the bank's physical facilities. The depository institution must delineate one or more assessment areas within which federal regulators evaluate the institution's record of meeting community needs.[23] When determining an assessment area, the institution "must . . . include the geographies in which the bank has its main office, its branches, and its deposit-taking ATMs, as well as the surrounding geographies in which the bank has originated or purchased a substantial portion of its loans."[24] Thus, a bank or thrift's physical deposit-taking facilities are the touchstone for evaluating its performance.

In the past, it was relatively easy to determine the geographic scope for the bank's community obligations because its physical facilities typically corresponded to the areas in which its depositors were located. But physical facilities increasingly do not correspond to deposit sources.

At least four situations demonstrate this trend. First, the rising number of Internet banks have either minimal physical presence, such as one office, or no physical deposit-taking facilities at all. The deposits received by such banks or thrifts are disconnected from any actual office. Relatively few Internet-only banks exist, but they highlight the need to clarify how institutions delineate the geographical area to which they are obligated. Moreover, the number of Internet banks is likely to increase. For example, Merrill Lynch announced plans to offer online banking services, and American Express has launched Membership Banking, an Internet banking service marketed to existing customers.[25] In September 2000, the ING Group, a Dutch insurance and banking giant that has acquired almost a dozen U.S. insurance firms, started ING Direct. ING Direct is an Internet bank that will initially market its products in the New York City and the greater Philadelphia/Wilmington metropolitan areas but plans to expand nationwide.[26] In addition, online brokers are purchasing online banks and vice versa.[27] Online brokers have been very successful in attracting online customers at reasonable cost, although online banks have been less successful. These mergers allow financial institutions to acquire customers and cross-market services more effectively.

The second example of the way in which banking is breaking its geographical bonds is the growing phenomenon of e-banking in banks with a branch network.[28] Recently, A.T. Kearney, Inc., a consulting firm, predicted that the percentage of households doing online banking will rise from 7 percent in 1999 to 31 percent in 2003.[29] CRA regulations currently assume that a branch bank serves as the source of such customers' deposits and the online operations merely provide a convenient means to conduct activities that would otherwise be conducted at the branch where the customer set up his or her account. With the passage of time and increased reliance on e-banking, this view may no longer hold. Current deposits, transferred online from securities accounts or other banks, may not be attributable to the branch at which the customer first opened an account many years ago.

Third, as the result of the GLBA and earlier efforts of insurance and securities firms to enter the banking business, bank or thrift deposits are likely to be generated from retail locations but not from the deposit-taking facilities. Current CRA regulations assume that deposits are generated from deposit-taking facilities, such as bank branches. Numerous examples of deposits generated by nondepository facilities have emerged. For example, nearly 16,000 State Farm agents throughout the country are being trained to sell bank products, including loan and deposit products such as savings accounts, certificates of deposit, and money market accounts. Deposits will be sent to, and loans made by, State Farm Bank, which has no branches.[30] Metropolitan Life Insurance Company, the Dutch ING Group, and Britain's Prudential PLC have announced similar plans for U.S. operations.[31]

Another example from the securities industry is Lehman Brothers. In June 1999, Lehman Brothers acquired a Delaware thrift with $87.5 million in assets,[32] and changed its name to Lehman Brothers Bank. With two branches, the bank began providing limited financial products to Lehman employees and clients, and its assets soon ballooned to $2.9 billion.[33] Recently, Lehman decided to use the bank to permit nonbank companies, such as real estate firms and national retailers, to offer retail banking services to their customers under their own brand names.[34]

The fourth example of banks' growing separation from physical space is that bank deposits are being generated by other financial activities in firms offering a full range of financial products. Many securities firms, including Merrill Lynch, Prudential Securities, Morgan Stanley Dean Witter, and Salomon Smith Barney are offering cash management accounts in which excess cash in securities accounts are swept into FDIC-insured accounts at thrifts or banks affiliated with the institutions.[35] A representative of Merrill Lynch predicted that this new feature of its cash management account "effectively will create one of the largest banks in the country almost overnight."[36]

Regulators are beginning to study changes in CRA regulations in light of these developments. One response, which has been used for Internet

banks, is to allow the assessment area to be based on the main office of the bank or the location of one or more physical branches or ATM sites, if any.[37] This approach ignores that such physical locations are not generating any, or—in the case of Internet banks with some branches or ATM locations—most deposits. One potential problem with this selection of CRA assessment areas is the fact that Internet banks and other major nonbank financial insitutions are not necessarily located in low and moderate income neighborhoods. A different response to the new disconnect between physical facilities and sources of deposits suggests itself from the Treasury Department's CRA baseline report. The report reveals wide variations in changes in lending to low and moderate income communities. For example, total loans to low and moderate income borrowers and areas grew by 43 percent for all lenders between 1993 and 1998. However, in fifty-four metropolitan statistical areas (MSAs), such loans grew by 90 percent or more, while in fifty MSAs such loans grew by less than 20 percent, and in twenty-two MSAs they did not grow or actually contracted.[38]

The report also found that small business lending by CRA reporting institutions in low and moderate income areas totaled $32 billion to $34 billion per year between 1996 and 1998.[39] However, the report found differences in the number and dollar amount of small business loans distributed across census tracts grouped by income. The number and dollar volume of loans in upper income areas substantially exceeded the proportion of population and businesses in those areas.[40] Even greater disparities in small business lending, as tabulated according to neighborhood income, have been revealed in specific geographical markets. For example, a study of the Milwaukee small business lending market found lending activity, in terms of number of loans and loan dollars, was much lower in low and moderate income areas.[41] Similarly, a study of the Chicago small business lending market found loan per firm rates substantially higher in higher income tracts than in lower income tracts.[42]

Rather than always base the delineation of an assessment area on a bank's main office, branches, and ATMs, additional options should be available. A bank should be available to several types of assessment areas. One new type of assessment area would focus on the geographic areas where a financial institution solicits deposits. Another option would allow banks to base their assessment area on a choice of a geographical area found to be in need of additional credit. The overriding principle guiding the choices made and regulatory review of those choices would be equal opportunity for access to credit on behalf of low and moderate income communities. Thus, if an Internet bank's main office is located in a wealthy suburb, the bank might use one of these alternate means of delineating an assessment area in order to reach low and moderate income residents. Regulators might also encourage banks to choose particular assessment areas based on the fact that they receive a small number of loans in relation to the number of low and moderate income residents. This would be a model not based on the traditional CRA responsibility scheme (i.e., the benefits

of the CRA accrue to the areas generating deposits). Rather, it is a model that views the CRA's purpose as providing equal opportunity to all communities in need.

Is such an approach permitted under existing law? The CRA imposes an obligation on an institution to meet "the credit needs of its entire community."[43] The term "community" is undefined in the statute, but the statute's purpose clause speaks of encouraging institutions to meet the credit needs of "the local communities where they are chartered" to do business.[44] Bank regulators decided to base an assessment area on the geographic location of deposit-taking facilities. This decision reflected a reality where deposit taking, the essence of the banking business, was being conducted at bank branches, and, later, ATM machines. This is an increasingly outdated reality.[45]

Given the changes in financial services, banks do business in each community where they solicit deposits. This includes the geographic areas where banks make themselves available for deposit taking. Thus, an Internet bank soliciting deposits by media advertising is making itself available in the geographic areas that the advertising reaches. A bank employing affiliated insurance agents or securities brokers to generate deposits is making itself available in the geographic areas where such agents and brokers do business. Given the wide distribution area easily reached by current solicitation practices, a bank may not be able to satisfy the credit needs of its entire solicitation area, i.e., the entire state, multistate, or nationwide area reached by its media advertising, Internet availability, or deposit production vehicles. Thus, it should be able to target specific low and moderate income assessment areas located within the broader solicitation area.

Evolution of a Legal Environment

The GLBA may further expand depository institutions' CRA activity. The 1990s witnessed a tremendous increase in CRA lending. By 1993, $30 billion had been committed by depository institutions as a result of the CRA.[46] By the summer of 1995, commitments had reached $61 billion.[47] Through the first quarter of 1998, commitments reached $397 billion,[48] and by the end of 1998 exceeded $1 trillion.[49] Part of the responsibility for this increase can be attributed to increased public pressure by community groups and increased federal regulatory scrutiny. Another part can be attributed to the large number of bank and thrift acquisitions and mergers,[50] as well as interstate expansions, all of which require CRA review as part of the approval process.

It is too early to tell what effect the GLBA will have on the level of CRA commitments, although the effect has not been noticeable to date. Pursuant to the GLBA, more than 300 bank holding companies have become financial holding companies,[51] an automatic change as long as the institutions are well managed and capitalized, and have received a satisfactory CRA rating.[52] In such cases, there is no need to convince regulators or community groups to approve or support the application via a CRA commitment.

When nonbanks acquire depository institutions, they trigger the CRA review process. Although there have been few acquisitions under the GLBA to date, the one reported acquisition (Charles Schwab Corp. and the U.S. Trust Corp.) contained no new or increased CRA commitment.[53] Prior to the GLBA's effective date, many nonbanks acquired thrifts to take advantage of the authorization for some bank-nonbank affiliations under existing law that would no longer be available under the GLBA.[54] Yet, no significant CRA announcements accompanied these acquisitions with the exception of a $6 billion CRA commitment by GMAC Bank.[55]

One explanation for this lack of activity is that the recently acquired and newly chartered institutions have been small enterprises. For example, State Farm's Internet bank had $162 million in deposits as of September 2000.[56] Lehman Brothers's acquisition had only $87.5 million in assets. Similarly, Metropolitan Life acquired a bank with $80 million in assets and $52 million in deposits.[57] Because expansion, including additional home mortgage and small business lending, will occur over time, CRA lending may also be expected to increase over time among these institutions.

Industry decisions are influenced by a number of factors, including not only specific legal requirements but also the entire regulatory environment. Over the last three decades, the regulatory environment has been characterized by increasing insistence on performance and increasing influence on institutions' willingness to make commitments. Although the GLBA threatens to reverse this trend by diluting the regulations, administrators may be able to head off the threat.

Three preliminary points must be made. The first involves the influence of the legal environment on business decisions. Organizational theorists have documented the way laws, including legislative requirements, administrative requirements, and court rulings, influence private organizations' policy and decision making.[58] This influence arises not only out of specific legal requirements but also the entire regulatory environment created by revisions to existing laws, regulators' interpretations of laws, and administrators' pronouncements and actions.

The second point concerns the nature of the CRA legal environment. There has been increasing public involvement as the result of legislative changes and administrative actions; strengthening of administrative requirements, including insistence on performance instead of promises; and increasing scrutiny of industry compliance with legislative and administrative requirements.[59] The result has been an increasingly responsive lending industry.[60]

Nonetheless, there remains a tension between the obligations imposed by the CRA and the industry's preferences. Industry members continue to view the CRA as permitting banks to be "held hostage" by community groups.[61] Senate Banking Committee Chairman Phil Gramm described this tension in these terms:

> It is amazing to me . . . [that] I can meet with the largest bankers or the smallest bankers . . . and in private every one of them hates CRA, every one

of them thinks it is extortion. And yet in public, they're all eager to run up and kiss it on the mouth.[62]

This leads to the third point—the profitability and riskiness of CRA lending. Earlier research provided some documentation of the perception of risk.[63] Last year, a Federal Reserve Board study showed that CRA home purchase and refinance lending was profitable for 50 percent of institutions, whereas overall home purchase and refinance loans were profitable for 70 percent of institutions.[64] For another 32 percent of institutions CRA lending was marginally profitable, whereas overall lending was marginally profitable for another 24 percent.[65] In other words, a smaller share of institutions finds CRA lending profitable. Moreover, when comparing relative profitability, 44 percent of institutions found profits to be lower for CRA loans.[66]

These differences become more pronounced when one compares profits of total dollar amounts of loans originated. CRA home purchase and refinance lending was profitable for 65 percent of CRA dollars originated, compared to 91 percent overall for loan dollars originated. Such CRA-related loans were marginally profitable for an additional 20 percent of CRA dollars originated, compared to 8 percent for overall loan dollars.[67] In terms of relative profitability, 63 percent of CRA dollars were composed of loans whose profitability was lower than overall lending profitability.[68]

The Federal Reserve Board study also focused on the profitability of special lending programs. These programs are one of the CRA's accomplishments, fostering a departure from traditional marketing activity and uniform underwriting criteria that excluded many low and moderate income borrowers from the market. Unfortunately, special lending programs were found to be even less profitable than CRA loans generally. Only 42 percent of loan dollars originated under special lending programs were profitable with another 14 percent marginally profitable.[69]

In terms of loan performance, many institutions report no differences between CRA-related and other home purchase and refinance lending. However, about half of the institutions had higher delinquency rates for CRA-related loans than for overall home purchase and refinance loans,[70] and 31 percent had higher charge-off rates.[71]

CRA home mortgage lending was never intended to lose money. Although profitable in large part, it is profitable for fewer institutions, and, most importantly, relative profitability frequently falls below that of overall home mortgage lending, as well as other lending or investment opportunities. In addition, for a substantial minority of institutions, CRA home mortgage lending leads to greater credit losses. Clearly, profit maximization is not going to induce most lenders to engage in and continue a robust level of CRA lending.

Given the tension between the desire to maximize profits and the duty to obey legal demands to serve low income communities, lenders will be inclined to do less to satisfy legislative mandates. The CRA and its regulations contain no specific measures for required performance. The level of

performance is determined by the institution and later subject to regulatory review. In a scheme characterized by uncertainty, the level of commitment will depend on the current view of the regulatory environment. That view was recently influenced by legislative debate on the GLBA and in the Act itself. The sequel was that there would be no retreat, but CRA obligations were not such a congressional favorite that they would be expanded.

Congress took two specific actions concerning which CRA requirements should be imposed on new financial services industries. First, Congress chose not to extend CRA-type requirements to other members of the financial industry (insurance companies, securities firms, mortgage banks, and finance companies), even though it recognized that community development requires a mix of loans, insurance, equity investment, and technical expertise.

Second, Congress required a satisfactory CRA rating of any bank that wished to create a financial holding company or a financial services subsidiary.[72] This second action sent a mixed message. On the one hand, CRA regulations had not previously been enforced when a bank organized or acquired a nonbank entity such as a securities firm.[73] In addition, CRA-based decisions to deny an application have always been discretionary. Now, CRA compliance is necessary to expand financial services activities, and a satisfactory CRA rating is mandatory. The obligation to maintain a satisfactory CRA rating is also a continuing one; no new financial services activity can be started and no financial services company can be acquired if any depository institution parent, affiliate, or subsidiary has a less than satisfactory CRA rating.[74]

Although this new requirement could be seen as a renewed congressional commitment to the CRA, there is another view. In recent years few institutions have received a CRA rating of less than satisfactory.[75] Thus, for almost all depository institutions, becoming a financial services corporation or forming a financial services subsidiary would be automatic. No regulatory agency or community group could question it and seek a promise of greater CRA activity by the applicant. This view suggests that Congress was wary of the negotiating power of community groups and federal agencies.

Third, the GLBA requires both depository institutions and any nongovernmental agency to report on agreements to provide cash payments, grants, or loans made pursuant to the CRA,[76] which may encompass written agreements made with community groups regarding future CRA commitments.[77] The so-called sunshine provisions of the GLBA are among the most controversial. Even if public scrutiny focuses on agreements to provide cash payments and loans directly to community groups, what signal does the GLBA send regarding Congress's view of such groups? Although it is well known that much of the CRA's effectiveness in inducing bank commitments is due to community group involvement, Federal Reserve Governor Edward Gramlich recently described the situation in this manner: "There are allegations that there is a lot of extortion in the process,

and there are a lot of denials. Now official records will be disclosed, and we'll see."[78]

For the moment, Congress has given the allegations a ring of truth by signaling that community groups might not be desirable participants in the CRA process. Moreover, the additional reports required when lenders and such groups agree to provide loans to a community serve as a disincentive to meet with community groups.

Fourth, the GLBA addressed the frequency of CRA examinations; exemptions were specifically sought and rejected for small banks. However, instead of examining small banks every two years, regulators will now examine them every four or five years, depending on whether the institution's previous rating was satisfactory or outstanding.[79] The lower frequency will apply to 80 percent of all banks and thrifts, thereby signaling that the CRA is burdensome.

In summary, the GLBA provided a mixed message. On the one hand, it mandates CRA compliance when depository institutions engage in new financial services. On the other, it questions community group involvement and the need for frequent federal oversight. However, the legal environment is determined only in part by legislative action. Regulatory action is equally important. Regulations issued pursuant to the GLBA, some of which are still interim, have insisted that lenders continue a commitment to CRA obligations. For example, in rules issued under the GLBA, federal regulators have rejected industry requests to expand financial activities when an institution lacks a satisfactory CRA rating but has a plan to improve its performance.[80] Instead, regulators insist on actual, satisfactory past performance. Early actions reflect a strong commitment to the CRA on the part of the federal regulators, and a continuing desire to encourage community participation.

Conclusion

As securities and insurance firms enter the home mortgage and small business loan markets, CRA lending may increase. If administrators consistently apply CRA regulations, such lending may increase further. Regulators can also help by focusing on the growing disconnect between deposits and bank or thrift deposit-taking facilities. These developments may usher in a new era of responsiveness to the needs of communities left behind in the surge of CRA lending during the 1990s. Finally, although the GLBA raised doubts concerning the strength of Congress's commitment to the CRA, those doubts have faded as regulators began to interpret the GLBA's requirements. Continued regulatory commitment is essential to ensure a strong signal is sent to the industry—a signal that robust CRA lending is still expected.

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1. 12 U.S.C. § 2902(2) (1994).
2. U.S. General Accounting Office, Pub. No. GAO/GGD 96-120, Hous-

ING ENTERPRISES, POTENTIAL IMPACTS OF SEVERING GOVERNMENT SPONSORSHIP 23 (May 1996). Home Mortgage Disclosure Act, 12 U.S.C. §§ 2801–2811. Data for 1992 revealed that of all home purchase loans made by lenders subject to the CRA, 51.3 percent were made by mortgage companies (either independent mortgage companies or mortgage company affiliates of depository institutions), 25.2 percent were made by commercial banks, 22.1 percent were made by savings associations, and 1.4 percent were made by credit unions. Glenn B. Canner et al., *Residential Lending to Low Income and Minority Families: Evidence from the 1992 HMDA Data*, 80 FED. RES. BULL. 73, 82 (1994). The Mortgage Bankers Association reported in 1994 that "in recent years, mortgage bankers have become the market leaders in home mortgage lending . . . . Mortgage bankers originated 51 percent of $506 billion of all of the loans made [in 1993]." *Community Investment Practices of Mortgage Banks, Hearing Before the Subcomm. on Consumer Credit and Ins. of the House Comm. on Banking, Fin., and Urban Affairs*, 103d Cong. 65 (1995) (testimony of Stephen B. Ashley, President, Mortgage Bankers Ass'n).

3. Mortgage companies originated the following percentage of one-to-four family mortgage loans:

1991	47 percent
1992	49 percent
1993	51.6 percent
1994	53.1 percent
1995	56.2 percent
1996	56.8 percent
1997	56.3 percent

Mortgage Bankers Association of America, *1-4 Family Mortgage Originations Market Share by Lender Group*, *available at* http://www.mbaa.org/marketdata/data99/market_share.html (visited July 20, 2000) (on file with author).

4. Robert E. Litan et al., *The Community Reinvestment Act After Financial Modernization: A Baseline Report*, U.S. DEP'T OF TREASURY 35-6 (April 2000) (computations completed by the author).

5. Rebel A. Cole et al., *Bank and Nonbank Competition for Small Business Credit: Evidence from the 1987 and 1993 National Surveys of Small Business Finances*, 82 FED. RES. BULL. 983, 988–89 (1996).

6. By 1997 three credit card issuers accounted for one-third of all small business loans. The top two lenders to small businesses, in terms of number of loans, were both credit card issuers. Joseph Kahn, *Banking on the Umbanks*, N.Y. TIMES, Feb. 4, 1999, at C1.

7. Consumer Bankers Association, *2000 Small Business Banking Study Executive Summary*, *available at* <http://www.cbanet.org/Surveys/hilites.html> (visited Aug. 1, 2000) (on file with author).

8. Rob Garver, *General Motors Granted Thrift Charter; Will Be an Instant Mortgage Leader*, AM. BANKER, Apr. 24, 2000, at 2.

9. Litan, *supra* note 4, at 65-67.

10. During the 1993-98 period, a total of $784.3 billion in loans were made by all lenders to low and moderate income borrowers in low and moderate income neighborhoods. Of this total, $467.1 billion (59.56 percent) in loans were made by CRA lenders and their affiliates, and $317.2 billion (40.44 percent) were made by others. *Id.* at 35-36.

11. According to Litan, "fully 85 percent of the growth in lending to LMI [low and moderate income] borrowers and areas among lenders not covered by the [CRA] has been due to the expanding activities of lenders specializing in 'subprime loans'—those borrowers with impaired or limited credit histories—and in loans collateralized by manufactured homes. Institutions covered by the CRA, on the other hand, have continued to focus on prime lending." *Id.* at 38-39. *See also id.* at 70 (percentage of growth in lending attributed to prime and subprime loans).

12. *Id.* at 74.

13. *State Farm Bank Extends Internet and Telephone Access Across United States*, PR Newswire, Mar. 29, 2000, *available at* http://www.westlaw.com.

14. Jessica Toonkel, *Merrill Adds Internet Bank to Growing Online Plan*, Am. Banker, Feb. 25, 2000, at 1.

15. Cheryl Winokur, *Merrill, Late to the Party, Offers Premium FDIC-Insured Account*, Am. Banker, Feb. 2, 2000, at 1.

16. For example, the Comptroller's regulations provide for consideration of affiliates' loans, 12 C.F.R. § 25.22(c) (2000), qualified investments, 12 C.F.R. § 25.23(c), and community development service, 12 C.F.R § 25.24(c).

17. Laura Mandaro, *Merrill, with Loan Plan, Bulls Further into Bank Turf*, Am. Banker, May 12, 2000, at 1 (the program includes a $120 million lending commitment to small businesses, $15 million to promote affordable housing credits, and $16 million to recruit and retain financial consultants to do outreach in minority areas).

18. The Office of the Comptroller of the Currency (OCC) requires national bank examiners to include operating subsidiary assets when assessing a national bank's capacity for reinvestment. However, it does not include assets of affiliates unless asked to do so by the holding company. OCC Banking Bull. 97-26 (July 3, 1997), Fed. Banking L. Rep. (CCH) ¶ 64-379. The Federal Reserve Board does not require consideration of assets of either a bank's subsidiary or affiliate unless asked to do so by the holding company. *The Gramm-Leach-Bliley Act: Hearing on Financial Services Modernization Before the Senate Comm. on Banking, Housing and Urban Affairs*, 106th Cong. 312 (1999) (statement of Allen J. Fishbein, General Counsel, Center for Community Change).

19. 12 U.S.C. §§ 2902(2), 2903 (1994). The CRA employs the definition of insured depository institution contained in the Federal Deposit Insurance Act, 12 U.S.C. § 1813(c)(2), which provides that "[t]he term 'insured depository institution' means any bank or savings association the deposits of which are insured by the Corporation pursuant to this chapter." *Id.*

20. There were 129 mortgage banking subsidiaries of bank holding companies and 201 mortgage banking subsidiaries of banks in 1996. *H.R.10—The Financial Services Modernization Act of 1999 Hearings Before the House Comm. on Banking and Fin. Services*, 106th Cong. 757 (1999) (testimony of John D. Hawke, Jr., Comptroller of the Currency, based on Federal Reserve Board data).

21. The performance test under current CRA regulations considers "institutional capacity and constraints, including the size and financial condition of the bank," as well as the performance of "similarly situated lenders." 12 C.F.R. § 345.21(b)(4), (5) (FDIC regulations).

22. OCC Banking Bull. 97-26, *supra* note 18. Regulators have addressed other situations in which bank practices may undermine proper assessment of CRA compliance, e.g., referral of loans not viewed favorably for CRA compli-

ance to bank affiliates. Federal Financial Institutions Examination Council, Community Reinvestment Act; Interagency Questions and Answers, 65 Fed. Reg. 25,088 (Apr. 28, 2000).

23. 12 C.F.R. §§ 25.41 (OCC), 228.41 (Federal Reserve), 345.41 (FDIC), and 563e.41 (OTS).

24. 12 C.F.R. §§ 25.41(c)(2), 228.41(c)(2), 345.41(c)(2), and 563e.41(c)(2).

25. Toonkel, *supra* note 14, at 1.

26. Joseph B. Treaster, *A Dutch Behemoth Invades America*, N.Y. Times, Aug. 26, 2000, at C1; *Dutch Financial Services Giant Targets New York Metro & Philadelphia-Wilmington, Del. Markets*, Bus. Wire, Oct. 10, 2000, *available at* http://www.westlaw.com.

27. Eric W. Aboaf and Scott Tanner, *Customer Acquisition Driving Bank-Broker Deals*, Am. Banker, July 6, 2000, at 14 (describing activities of TD Waterhouse, affiliated with TD Bank, and E-Trade, affiliated with Telebank).

28. The OCC reported that among national banks, 161 offered transactional Internet banking as of June 30, 1998. Kori L. Egland, Karen Furst, Daniel E. Noble, and Douglas Robertson, *Banking Over the Internet*, OCC Q.J., Dec. 1998, 25, 27. As of mid-September 1999, 541 national banks offered transactional Internet banking. Electronic Banking, 65 Fed. Reg. 4895 note 1 (Feb. 2, 2000). It was projected that 45 percent of all national banks will be offering transactional Internet banking by the beginning of 2001. Such banks will account for 95 percent of the assets and 93 percent of the small deposit accounts at national banks. Karen Furst, William W. Lang, and Daniel E. Nolle, *Who Offers Internet Banking?* OCC Q.J., June, 2000, at 29.

29. Megan J. Ptacek, *Online Banking: Study Finds Web Banks at Disadvantage*, Am. Banker, June 13, 2000, at 14.

30. David Reich-Hale, *Insurer Heading for Bank Turf with 16,000 Lenders*, Am. Banker. *See also State Farm Bank Extends Internet and Telephone Access Across United States*, PR Newswire, Mar. 29, 2000, *available at* http://www.westlaw.com.

31. Amy Friedman, *Armed with a Charter and a Sales Force, ING Barings Readies U.S. Retail Campaign*, Am. Banker, Sept. 13, 2000, at 1 (discussing plans of ING, State Farm, and Metropolitan Life); Robert A. Bennett and Mark Graham, *Foreign Insurers Invade U.S. Banking*, U.S. Banker, Oct. 2, 2000, at 36 (discussing plans of Prudential PLC); David Reich-Hale, *State Farm Bank—Product Sales Force Growing Fast*, Am. Banker, Sept. 7, 2000, at 6 (discussing plans of Metropolitan Life and State Farm). Metropolitan Life has 11,000 agents across the country. *Id.*

32. *Lehman Thrift Deal Gets OTS Approval*, Nat'l Mortgage News, July 5, 1999, http://www.westlaw.com.

33. Jessica Toonkel, *Lehman Set to Sell Bank Services to Nonbanks; Companies With Strong Brands Could Private-Label Loans and Deposit Accounts*, Am. Banker, May 16, 2000, at 1.

34. *Id.*

35. Cheryl Winokur, *Merrill, Late to the Party, Offers Premium FDIC-Insured Account*, Am. Banker, Feb. 2, 2000, at 1.

36. *Id.* (quoting James Perilstein, First Vice President of Client Relationship Marketing, Merrill Lynch).

37. Six applications for bank charters involving banks with no traditional banking offices accessible to the public were submitted to the OCC in the 1997–

2000 period. In all six, the bank's assessment area was based on the main office and the location of ATMs, if any. Hutton National Bank, Conditional Approval No. 383, Apr. 13, 2000; Pointpathbank, National Association, Conditional Approval No. 368, Apr. 3, 2000; AeroBank.Com, N.A., Conditional Approval No. 347, Jan. 29, 2000; CIBC National Bank, Conditional Approval No. 313, July 9, 1999; NextBank, N.A., Conditional Approval No. 312, May 8, 1999; and CompuBank, N.A., Conditional Approval No. 253, Aug. 20, 1997. All OCC decisions are found at Comptroller of the Currency, Internet Banking, *available at* http://www.occ.treas.gov/netbank/ibi.htm (visited Oct. 3, 2000). Examples of this approach are also discussed in William M. Keyser, Comment, *The 21st Century CRA: How Internet Banks Are Causing Regulators to Rethink the Community Reinvestment Act*, 45 N.C. BANKING INST. 545, 554 (2000).

38. Litan, *supra* note 4, at 81.

39. *Id.* at 48.

40. *Id.* at 49-50. Specifically, the Baseline Report revealed the following in aggregate lending:

Percent of Population, Small Businesses and Small Business Lending by Area Income, 1996-98

Area Income	Population	Small Businesses	Number of Small Business Loans	Dollar Volume of Small Business Loans
Low Income	4.9 percent	5.3 percent	4.4 percent	5.2 percent
Moderate Income	18.5 percent	18.2 percent	15.6 percent	15.7 percent
Middle Income	53.2 percent	49.9 percent	49.5 percent	46.8 percent
Upper Income	23.3 percent	26.1 percent	30.0 percent	31.6 percent

Id. at 50, Table 3.

41. Gregory D. Squires and Sally O'Connor, *Access to Capital: Milwaukee's Small Business Lending Gaps*, *in* BUS. ACCESS TO CAPITAL AND CREDIT 93 (Federal Reserve System Research Conference, Mar. 8-9, 1999). *See also id.* at 89 (upper-income tracts received over 37 percent of loans and loan dollars but accounted for 27.1 percent of population and 32.2 percent of all businesses, while low income tracts received approximately 5.5 percent of all loans and loan dollars while accounting for 12.7 percent of population and 8.8 percent of all businesses).

42. Daniel Immergluck, *Interurban Patterns of Small Business Lending: Findings from the New Community Reinvestment Act Data*, *in* BUS. ACCESS TO CAPITAL AND CREDIT 127 (the lending rate is 50 percent higher in upper income tracts than in low income tracts). The Woodstock Institute first documented disparity in small business lending in a 1995 study of Small Business Administration (SBA) section 7a loans in the San Antonio area. It found that lower income zip codes contained 55 percent of the nonmanufacturing establishments and received only 34 percent of the loans to such firms. In a 1997 study of SBA 504 loans in the Chicago metropolitan area, the Woodstock Institute found that lower income areas contained 50 percent of manufacturing firms but received only 33 percent of SBA 504 loans to manufacturers. Such areas contained 46

percent of all retail firms that received only 30 percent of SBA 504 loans to retailers. Finally, such areas contained 42 percent of wholesale firms but received only 32 percent of SBA 504 loans to wholesalers. *Hearings on the Effectiveness of Small Business Administration Loan Programs Before House Comm. on Small Bus.*, 105th Cong. 21 (1997) (testimony of Daniel Immergluck, Vice President, Woodstock Institute).

43. 12 U.S.C. § 2903(1) (1994).

44. 12 U.S.C. §§ 2901(b) (purpose), 2901(a) (congressional findings).

45. OCC Interpretive Letter No. 638, Fed. Banking L. Rep. (CCH) ¶ 83,525 (Jan. 6, 1994). In the 1994 interpretive letter the Office of the Comptroller of the Currency indicated it had never ruled on the status of deposit production offices operated by one national bank in the 1980s, but in 1978, in an unpublished letter, it had approved an office that provided information on deposit accounts, application forms, and envelopes for mailing forms and deposits to the bank. *Id.*

46. Allen J. Fishbein, *The Community Reinvestment Act After Fifteen Years: It Works, But Strengthened Federal Enforcement Is Needed*, 20 FORDHAM URB. L.J. 293, 294, 298 (1993) (estimate by the Center for Community Change).

47. NATIONAL COMMUNITY REINVESTMENT COALITION, CRA DOLLAR COMMITMENTS SINCE 1977 (1995) (calculations completed by the author).

48. NATIONAL COMMUNITY REINVESTMENT COALITION, CRA COMMITMENTS 1977–1998 11 (1999).

49. The National Community Reinvestment Coalition determined $600 billion in CRA commitments have resulted from the megamergers announced in 1998, bringing total CRA commitments to more than $1 trillion. *NCRC Kicks Off National Community Response to Megamergers: Testifies Before Congress and Spearheads Activism Resulting in $1 Trillion of CRA Agreements*, REINVESTMENT WORKS (Nat'l Committee Reinvestment Coalition, Washington, D.C., Fall 1998), at 2.

50. Over the past ten years, the number of banks in the United States declined by 30 percent. Edward G. Boehne, *Financial Modernization: Vastly Different or Fundamentally the Same?* BUS. REV. (Federal Reserve Bank of Philadelphia) July–Aug. 2000, 3, 5. Much of the decline resulted from mergers and acquisitions among existing banks and bank holding companies. *Id.* During this period several hundred mergers and acquisitions occurred each year. *Id.*

51. The Federal Reserve has reported that as of June 26, 2000, 314 bank holding companies had elected to become financed holding companies. 5 Fed. Banking L. Rep. (CCH) ¶ 59-422 (press release, Board of Governors of the Federal Reserve System).

52. Gramm-Leach-Bliley Act of 1999, Pub. L. No. 106-102, §§ 103(b) (financial holding company), 121(a) (financial subsidiary), 113 Stat. 1338, 1350, and 1373 (1999).

53. The Charles Schwab Corporation, 86 FED. RES. BULL. 494 (2000).

54. The GLBA prohibits affiliation of depository institutions with commercial firms through a unitary thrift charter. Gramm-Leach-Bliley Act, Pub. L. No. 106-102, § 401.

55. Garver, *supra* note 8, at 2.

56. David Reich-Hale, *State Farm Bank—Product Sales Force Growing Fast*, AM. BANKER, Sept. 7, 2000, at 6. When State Farm first received approval for a federal thrift charter in 1998 it voluntarily committed to make $195 million in loans to low and moderate income borrowers in the states it served during its

first three years of operation. *State Farm Secures Federal Thrift Charter from OTS*, BANKING POL'Y REP., Nov. 30, 1998, at 2. Its long-term goal was CRA-related loan commitments equal to the greater of 5 percent of the thrift's assets or the amount of deposits generated from low and moderate income persons. *Id.*

57. Martin Sikora, *MetLife Enters Banking with Grand Bank Deal*, MERGERS AND ACQUISITIONS, Oct. 1, 2000, *available at* http://www.westlaw.com.

58. Sim B. Sitken and Robert J. Bies, *The Legalization of Organizations: A Multi-Theoretical Perspective*, *in* THE LEGALISTIC ORG. 19–49 (Sim B. Sitkin and Robert J. Bies eds. 1994); LAUREN B. EDELMAN, *Legal Environments and Organizational Governance: The Expansion of Due Process in the American Workplace*, 95 AM. J. SOC. 1401–40 (1990) (diffusion of due process protections in the workplace due to normative environment created by law).

59. Vincent Di Lorenzo, *Equal Economic Opportunity: Corporate Social Responsibility in the New Millennium*, 71 U. COL. L. REV. 51, 89–104 (2000).

60. *Id.* at 104–20.

61. *Economic Growth and Regulatory Paperwork Reduction Act: Hearings on S. 650 Before the Subcomm. on Financial Institution and Regulatory Relief of the Senate Comm. on Banking, Hous., and Urban Affairs.* 104th Cong. 339 (1995) (statement of James M. Culberson, president-elect, American Bankers Ass'n). *See also* Di Lorenzo, *supra* note 59, at 113–16.

62. Rob Garver, *Gramm Urges Thrifts to Refuse Demands for Cash in CRA Disputes*, AM. BANKER, Mar. 8, 2000, at 2.

63. Di Lorenzo, *supra* note 59, at 115.

64. BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, THE PERFORMANCE AND PROFITABILITY OF CRA-RELATED LENDING (2000).

65. *Id.* at xvii, chart 1a and 1b.

66. *Id.* at chart 1c.

67. *Id.* at xvii, charts 2a and 2b.

68. *Id.* at chart 2c.

69. *Id.* at xxiv, chart 8b.

70. *Id.* at vi. *See also* table 3c.

71. *Id.* at 48, table 3c.

72. Gramm-Leach-Bliley Act of 1999, Pub. L. No. 106-102, §§ 103(b) (financial holding company), 121(a) (financial subsidiary), 113 Stat. 1338, 1350 and 1373 (1999).

73. 12 U.S.C. § 2903 (1994) (CRA record is taken into account in evaluation of an application for a deposit facility).

74. Gramm-Leach-Bliley Act § 103(a) (adding subsection (l)(2) to section 4 of the 1956 Bank Holding Company Act).

75. In congressional testimony preceding passage of the Gramm-Leach-Bliley Act, there were several witnesses who testified that 97 percent of institutions received a rating of satisfactory or better. *The Gramm-Leach-Bliley Act: Financial Services Modernization Hearings Before the Senate Comm. on Banking, Hous. and Urban Affairs*, 106th Cong. 178, 185, 200, 309 (1999) (statements by Senator Sarbanes, F. Barton Harvey of The Enterprise Foundation, and Deborah B. Goldberg of the Center for Community Change). However, the FDIC had also provided evidence that as of December 31, 1998, 0.8 percent of FDIC-supervised institutions with less than $100 million in assets and 0.77 percent of such institutions with more than $100 million in assets were rated less than "satisfactory" in CRA evaluations. *Id.* at 129.

76. Gramm-Leach-Bliley Act § 711.

77. Disclosure and Reporting of CRA-Related Agreements, 66 Fed. Reg. 2052 (Jan. 10, 2001) (to be codified at 12 C.F.R. §§ 35.2(d)(4), 207.2(d)(4), 346.2(d)(4), 533.2(d)(4)). The joint final rule on disclosure and reporting of CRA-related agreements includes agreements with community groups to extend loans to a particular community within its requirements.

78. Rob Garver, *Gramm Urges Thrifts to Refuse Demands for Cash in CRA Disputes*, AM. BANKER, Mar. 8, 2000, at 2.

79. Gramm-Leach-Bliley Act § 712.

80. Financial Subsidiaries and Operating Subsidiaries, 65 Fed. Reg. 12,905, 12,907 (Mar. 10, 2000) (Office of the Comptroller of the Currency).