



The Inside Track

Unfinished Business: Updating CRA

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By Kate Davidson

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The financial services landscape has shifted dramatically since the Community Reinvestment Act was passed in 1977 and even more since its last major overhaul in 1995.

Fewer banks control more of the assets, branch networks extend far beyond a bank's headquarters and nonbank lenders originate a sizable share of the nation's mortgages. In general, experts say, the changes have made CRA rules less relevant, the ratings less reliable and the law less effective at meeting the needs of communities.

But efforts are under way to improve it. Democratic lawmakers have introduced legislation that would modernize CRA, while regulators have been holding hearings throughout the country, eliciting feedback of their own.

Advocates of the law view CRA reform as unfinished business left over from the Dodd-Frank Act, and a slew of ideas have emerged to improve the legislation, including expanding the ways banks can earn CRA credit; subjecting all financial services companies to the law; and tying CRA scores to how well a community's needs are met.

Many bankers, of course, would like to see CRA disappear entirely. Community bankers in particular have long argued that they are in business to serve the needs of their communities and do not need a law to make sure they are doing their job. But bankers also recognize that CRA is here to stay and, as policymakers debate ways to improve it, industry experts such as Eugene Ludwig, the chief executive of Promontory Financial Group and former comptroller of the currency, and Ellen Seidman, a former director of the Office of Thrift Supervision, have offered a number of recommendations to make CRA work better for banks and the communities they serve.

One oft-repeated proposal is to require all financial services companies to meet the same CRA obligations as banks. Opponents of this idea argue that banks are subject to CRA because they benefit from unique government "safety nets," including federal deposit insurance. But with the recent financial crisis, the net has stretched beyond the banking sector-and so, too, should the obligation to reinvest in communities, says Ludwig.

"Other financial institutions that have clearly benefited from government intervention in the capital markets should now bear some of the responsibility for CRA as well," he says.

A bill introduced in the House in late September would require compliance for independent mortgage companies, hedge funds and investment banks (but, to bankers' dismay, not credit unions.) Massachusetts, which has its own CRA law that applies to credit unions and nonbank mortgage lenders, could serve as a useful model of how to impose the law more broadly.

In evaluating nonbank lenders, examiners review the success of those lenders' mortgage modification programs, and whether those loans were suitable for the borrower in the first place. "You have to take into account the differences in the business model when you're developing your examination process," says Steve Antonakes, the Massachusetts commissioner of banks.

Supporters of CRA reform have also called for broadening the assessment area in which banks' CRA activities are evaluated, and including bank holding company affiliates-such as a mortgage lender or an investment firm-in that evaluation.

Seidman says the changes are necessary in a world in which financial services are provided more and more by holding companies and their affiliates, which benefit from the same "safety nets" available to banks.

"If part of the quid pro quo for that is an obligation to serve all parts of the community, how can we justify imposing the requirement on only one part of the company, rather than on all of the holding company and all of its subsidiaries and affiliates-or at least all of its subsidiaries and affiliates that do most of the same things that banks and thrifts do?" Seidman asks.

In addition, the obligations often apply to only a portion of the geographic area in which a bank operates. Though Bank of America Corp. has more than 6,000 offices in 36 states, it will not, for example, get credit if it makes a development loan in New Orleans' Ninth Ward because it has no branches in Louisiana.

Over the years, much CRA lending has become housing-focused, but that was not the original intent. Placing a renewed emphasis on community development projects and small-business lending, and even expanding the ways that banks can earn CRA credit, could go a long way toward jumpstarting lending and reviving distressed neighborhoods, says John Taylor, the CEO of the National Community Reinvestment Coalition.

Though examiners consider small-business activity in CRA evaluations, data on small-business lending is minimal, Taylor says. Expanding the kind of information collected-such as lending to minority- or women-owned businesses-will encourage examiners to take a closer look at small-business lending and help banks determine where to direct resources. It is also critical to job creation and economic development, he says.

Examiners should also consider extra credit for banks that develop innovative products and programs, such as savings programs tailored to low- and moderate-income customers, or initiatives to support financial literacy, Ludwig says.

"Some of what is needed is simply providing more flexibility and allowing banks to unleash their natural creativity," Ludwig says. "This approach should not require one whit of additional burden, or one whit of additional examination, but it should allow banks to more effectively fulfill their obligations."

William Askew, a senior policy adviser at the Financial Services Roundtable, told lawmakers in April that regulators should give more consideration to high-impact projects, such as opening and maintaining homeownership preservation offices in low-income neighborhoods, and donating, or selling at a deep discount, properties to community groups.

Others say banks should also be given credit for investing in community development financial institutions, regardless of where they are located. Banks now only receive credit for such investments in their assessment areas.

Of course, doubling or tripling CRA-related activities will not mean a thing unless those efforts meet the needs of the community. Yet, for a host of technical reasons, regulators often do not consider need when evaluating a bank's CRA score. Seidman says they should.

"We've got to do a much better job of matching community needs to what actually gets credit," Seidman says.

Part of that includes improving-and putting a stronger emphasis on-the CRA service test. The test evaluates the services that banks offer to customers, such as credit or homebuyer counseling or providing technical assistance about financial services for community groups. But Seidman says the test, which counts for just 25 percent of a bank's CRA score, focuses more heavily on where a bank's branches are located, rather than the services they provide.

Taylor says regulators used to consult with community groups, review demographic data and talk to consumers ahead of CRA exams, but they do less of it now. Modifying the regulations to explicitly require this kind of review would not only ensure that needs are met, but also help banks avoid spending time on activities that are counterproductive, such as originating more mortgages to meet production goals when a grant might better meet the needs of the community, says Mark Willis, a resident research fellow at New York University's Furman Center for Real Estate and Urban Policy.

Ultimately, Willis says, any changes to CRA should ensure better enforcement. In an attempt to streamline the process, exams have become more quantitative, limiting the ability of examiners to give credit for activities that have an incremental impact on communities, Willis says.

At a joint hearing of regulators at the Federal Reserve Bank of San Francisco in August, Willis also said that any change to CRA should lay out a regular process for updating the law.

"The longer the time between changes, the more pressure builds up for more extensive changes and the increased likelihood that the players will take sides and hold to more rigid positions," he said.

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