AMERICAN BANKER
On Focus and In Depth

LEGAL/REGULATORY

Revise the CRA's Rules to Make It More Relevant

American Banker | Thursday, October 14, 2010

By Kate Davidson

The financial services sector 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 announced in September that they were drafting a bill to modernize CRA, while regulators have been holding hearings throughout the country, eliciting feedback of their own.

"In a dynamic financial marketplace and global economy, things are bound to change, and new needs arise as the economy and financial sector evolves," said Eugene Ludwig, the chief executive of **Promontory Financial Group** and former comptroller of the currency. "To keep the act modern, one really has to … review it from time to time."

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.

Of course, many bankers 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 — and the examinations that come with it — to make sure they are doing their job. But bankers also recognize that the law is here to stay and, as policymakers debate ways to improve it, Ludwig and other experts have offered a number of recommendations to make CRA work better for banks and the communities they serve. Here are five of them.

Include All Financial Services Firms
One of the most significant and oft-repeated proposals is to require all financial services companies to meet the same CRA obligations as depository institutions. Opponents of this proposal have long argued that banks are subject to CRA because they benefit from unique government "safety nets," including federal deposit insurance and lower interest rates through the **Federal Reserve Board**. But with the recent financial crisis, the net has stretched beyond the banking sector — and so, too, should the obligation to reinvest in communities, said 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 said.

Advocates of the law say it should extend to credit unions, independent mortgage companies, investment banks, securities firms, insurance companies and other financial services firms.

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.

Credit unions, for example, are allowed to define their entire membership as their assessment area. And 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. "The key thing that we learned in applying CRA to credit unions and mortgage lenders is they are similar, but distinctly different businesses," said Steve Antonakes, the Massachusetts commissioner on banks. "And you have to take into account the differences in the business model when you're developing your examination process."

Credit unions have long been opposed to inclusion in CRA, arguing that they already meet the obligations because their mission is to fulfill the lending needs of members. Imposing new regulations on them and other financial services companies likely will not happen without a fight.

Give The Whole Picture

Supporters of CRA reform say one of the biggest flaws is that regulators are not considering the whole of a bank's operations when evaluating its lending record.

To that extent, many have 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.

Ellen Seidman, the former director of the Office of Thrift Supervision, said the change is 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 asked.

In addition, the obligations often apply to only a portion of the geographic area in which a bank operates.

Although **Bank of America** Corp. has more than 6,000 offices in 36 states across the country, it will not, for example, get credit if it makes a development loan in New Orleans' Ninth Ward, because it has no deposit-taking branches in Louisiana.

And in the case of some national banks that make the majority of their loans through brokers — rather than branches — the CRA assessment area often includes just the area around their headquarters.

"So you might have a lot of resources that are focused in that particular area, but there are other areas where resources are not extended because the banks are not headquartered there," said Warren McLean, the vice president of development at **Community Reinvestment Fund, USA** in Minneapolis, a national nonprofit and community development financial institution.

For example, **FIA Card Services** — formed when Bank of America Corp.'s credit card subsidiary bought MBNA America Bank in 2006 — is the largest credit card issuer in the United States, with more than $207.3 billion in assets. But its assessment area includes only New Castle County, Del. — the area where its headquarters is located.

While expanding assessment areas may put more pressure on banks to lend to more communities, it also makes it easier for them to find projects in which to invest. One criticism of broadening the assessment area, though, is that the benefit would only extend to larger banks and could create more competition for CRA-related activities for smaller banks.

Give More Weight To Business Lending

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, said John Taylor, the president and CEO of the **National Community Reinvestment Coalition**.

Although examiners consider small-business activity in CRA evaluations, nationwide data on small-business lending is minimal, Taylor said. 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 revitalization, he said.

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

"Some of what is needed is simply providing more flexibility and allowing banks to unleash their natural creativity," Ludwig said. "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- and moderate-income neighborhoods, and donating, or selling at a deep discount, properties to local community groups.

And McLean said banks should also be given credit for investing in community development financial institutions, regardless of where they are located, and for making longer-term loans and investments, which he said better fit the needs of small businesses. As it is now, banks only receive credit for such investments in their assessment areas.

Tie Assessment To Actual Need

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 and others said they should. "We've got to do a much better job of matching community needs to what actually gets credit," Seidman said.

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 offering credit or homebuyer counseling or providing technical assistance about financial services for community groups. But Seidman says the test, which counts for just 25% of a bank's CRA score, focuses more heavily on where a bank's branches are located, rather than the services they provide at those branches and whether people are actually making use of them.

"These things have just never been important in the CRA evaluation," she said.

Taylor said 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 not only ensures that needs are met, but also helps 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, said Mark Willis, a resident research fellow at New York University's Furman Center for Real Estate and Urban Policy.

More Flexible Enforcement

Ultimately, any changes to CRA should ensure better, more consistent enforcement, and should lay out a regular process for updating the law, Willis said.

"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 told a joint hearing of regulators at the **Federal Reserve Bank of San Francisco** in August.

In an attempt to streamline the examination process and provide more consistency, exams have become more quantitative, limiting the ability of examiners to give credit for activities that have an incremental impact on communities, Willis said.

Any new regulation or statute should include a process for continual training of examiners, but also should empower them to make more qualitative decisions on the effectiveness of a bank's CRA activities, Willis said.

Likewise, any legislative changes should avoid specifying details that may need frequent updating to be responsive to future developments.

Not everyone agrees. Taylor at the National Community Reinvestment Coalition said, "You're better off trying to legislate fair and equal access [to credit] and guaranteeing that that happens than relying upon a regulatory body one day to say, 'OK, we'll enforce it this way,' then next time, 'Well, we're not going to really enforce it the same way,' or 'It's not as important to us.' "

© 2010 American Banker and SourceMedia, Inc. All Rights Reserved.
SourceMedia is an Investcorp company. Use, duplication, or sale of this service, or data contained herein, except as described in the Subscription Agreement, is strictly prohibited.

For information regarding Reprint Services please visit: http://www.americanbanker.com/aboutus/reprint-services-rates.html