NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

Testimony

Testimony of
John Taylor, President and CEO

On behalf of the
National Community Reinvestment Coalition

On the topic of
"Community and Consumer Advocates' Perspectives on the Obama Administration's Financial Regulatory Reform Proposals"

Submitted to the
United States House of Representatives
Committee on Financial Services
2128 Rayburn House Office Building

Thursday, July 16, 2009

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I. Introduction

Good morning, Chairman Frank, Ranking Member Bachus, and other distinguished members of the Committee. I am John Taylor, President of the National Community Reinvestment Coalition (NCRC), and I am honored to testify today before the House Financial Services Committee on behalf of NCRC on the topic of "Community and Consumer Advocates' Perspectives on the Obama Administration's Financial Regulatory Reform Proposals."

NCRC is an association of more than 600 community-based organizations that promotes access to basic banking services, including credit and savings, to create and sustain affordable housing, job development, and vibrant communities for America's working families.

II. The Need for a Consumer Financial Protection Agency (CFPA) and CFPA Enforcement of the Community Reinvestment Act

The sharp economic decline resulting from the foreclosure crisis can be traced to out-dated consumer protection laws and failed regulatory oversight. Loopholes in the law and inadequate regulatory enforcement allowed abusive and problematic lending to flourish, which led to the destabilization of the US economy. The foreclosures that arose from predatory lending have not only severely undermined the financial stability of working families and communities but also are now weakening the credit markets and diminishing overall economic activity and performance. Massive foreclosures are spurring a self-reinforcing cycle of defaults, declines in home values, and rising unemployment.

The current crisis demonstrates the urgent need for comprehensive regulatory reform and the establishment of a federal agency focused exclusively on consumer protection. As the Obama Administration notes in its paper "Financial Regulatory Reform: A New Foundation," "Consumer protection is a critical foundation for our financial system. It gives the public confidence that the financial markets are fair and enables policy makers and regulators to maintain stability in regulation. Stable regulation, in turn, promotes growth, efficiency, and innovation over the long term." For these reasons, NCRC agrees strongly with the Administration that consumer protection needs an "independent seat at the table in our financial regulatory system" and that the CFPA would be that independent seat. For too long, consumer protection has played a marginal role in the U.S. regulatory system. In order to deter future foreclosure crises of this scale and magnitude, consumer protection must be elevated to one of the core priorities in the U.S. regulatory system through the establishment of a dedicated agency that gives consumer protection a principal role in federal oversight, regulatory reform, and fair lending enforcement.

When I was serving on the Federal Reserve Board's Consumer Advisory Council, I would hear Federal Reserve staff talk about serving their "clients." I initially thought clients meant the taxpayers but then I was shocked to learn that clients meant banks that were "members" of the Federal Reserve System. These semantics suggest that the agencies view their mission as primarily safeguarding the wellbeing of banks. While I agree that the wellbeing of banks is important, our country needs a new agency which sees its mission as safeguarding the interests of consumers.

A central element of consumer protection is the Community Reinvestment Act (CRA). CRA requires banks to meet the credit needs of communities, including low- and moderate-income communities, consistent with safety and soundness. As a result of CRA's prudent lending requirement, the Federal Reserve found that of all the high-cost loans issued in 2006, only 6 percent were considered on bank CRA exams and were made by banks to low- and moderate-income borrowers or neighborhoods.[1] The vast majority of the risky lending was issued by non-CRA covered mortgage companies over the years. Further research by the Federal Reserve documents that loans made by banks in geographical areas on CRA exams are about half as

[1] Randall Kroszner, former Federal Reserve Governor and currently at Booth School of Business, University of Chicago, *The Community Reinvestment Act and the Recent Mortgage Crisis*, in Revisiting the CRA: Perspectives on the Future of the Community Reinvestment Act, A Joint Publication of the Federal Reserve Banks of Boston and San Francisco, February 2009, http://www.frbsf.org/publications/community/cra/index.html

likely to end up in foreclosure as loans issued by independent mortgage companies.[2] Federal Reserve Chairman Ben Bernanke concludes, “Our own experience with CRA over more than 30 years and recent analysis of available data, including data on subprime loan performance, runs counter to the charge that CRA was at the root of, or otherwise contributed in a substantive way, to the current mortgage difficulties.”[3]

Repeated assertions from some ideological pundits concerning CRA’s contribution to the foreclosure crisis is a “big lie” strategy; yet loudly repeating this lie does not make it true. In fact, the reverse is true. If CRA’s safety and soundness requirement had been applied broadly throughout the financial services industry, the U.S. economy would not be increasingly unhinged as a result of mounting foreclosures, widespread job loss, and a potentially steep and protracted recession.

Since CRA is a central component of consumer protection and CFPA will be the central agency to protect consumers, CFPA must be charged with enforcing CRA. NCRC strongly supports the Administration’s proposal to place CRA under the jurisdiction of CFPA, and asks that the Chairman and the Committee amend H.R. 3126 (the Consumer Financial Protection Agency Act of 2009) to mandate that CRA be under the jurisdiction of CFPA. We understand that bank industry trade associations lobbied vigorously to retain the jurisdiction of the current bank agencies over CRA. The industry supports CRA in the existing bank agencies because the fragmented regulatory enforcement has resulted in inconsistent enforcement of CRA that too often accommodates the priorities of the industry at the expense of working communities. A lack of uniform and rigorous CRA enforcement means that CRA has not yet realized its full potential in terms of leveraging loans, investments, and services for families and communities. In fact, recent regulatory changes have reduced the amount of lending and investing in

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[2] Elizabeth Laderman and Carolina Reid, Federal Reserve Bank of San Francisco, “CRA Lending during the Subprime meltdown in Revisiting the CRA: Perspectives on the future of the Community Reinvestment Act,” a Joint Publication of the federal Reserve Banks of Boston and San Francisco, February 2009, http://www.frbsf.org/publications/community/cra/cra_lending_during_subprime_meltdown.pdf

[3] Letter from Ben. S. Bernanke, Chairman of the Board of Governors of the Federal Reserve System to Senator Robert Menendez, November 25, 2008.

communities. It is time to send the message that banks can no longer buy their way out of accountability.

III. The Shortcomings of Current CRA Enforcement

Four agencies (the Federal Reserve Board, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision) have been in charge of enforcing CRA and updating CRA regulations and examination procedures. As the Administration's white paper asserts, oversight of CRA and other fair lending laws has been fragmented among the four agencies, making the regulatory rulemaking process slow, creating opportunities for "regulatory arbitrage," and institutions shopping for a regulatory agency that is least restrictive. Because of this, CRA enforcement became inconsistent among the four agencies; specifically, the agencies were not able to update their regulations and examination procedures quickly enough to keep pace with changes in the industry, and enforcement ranged from mediocre to negligent.

The last time the agencies strengthened CRA regulations in any significant manner was in 1995 under a mandate from the Clinton Administration. Since that time, the agencies have weakened CRA regulations.

CRA Grade Inflation

One visible manifestation of the inadequacies of current CRA enforcement is grade inflation. Banks receive one of four ratings on their CRA exams: Outstanding, Satisfactory, Needs-to-Improve, and Substantial Non-Compliance. The last two ratings are considered failing ratings. As the table below shows, the current failure rate for banks has hovered between 1 to 2 percent in recent years. When ratings first became public in 1990, more than 10 percent of banks failed their CRA exams[4]. During the first five years of the public availability of CRA ratings, more

[4] See http://www.ffiec.gov/craratings/default.aspx for the database on CRA ratings.

than 5 percent of banks failed their CRA exams every year (over the five year time period, 7.6 percent of the banks failed).

Year	Outstanding		Satisfactory		Needs to Improve		Substantial Noncompliance		Total
	Count	Percent	Count	Percent	Count	Percent	Count	Percent	
1990	340	10.9%	2,474	79.5%	280	9.0%	19	0.6%	3,113
1991	407	8.3%	4,016	81.6%	453	9.2%	46	0.9%	4,922
1992	653	12.7%	4,067	78.9%	395	7.7%	40	0.8%	5,155
1993	941	14.7%	5,060	79.3%	355	5.6%	26	0.4%	6,382
1994	1,000	18.1%	4,249	76.7%	275	5.0%	15	0.3%	5,539
1995	1,363	24.3%	4,106	73.1%	138	2.5%	7	0.1%	5,614
1996	1,214	26.5%	3,275	71.5%	81	1.8%	11	0.2%	4,581
1997	829	22.4%	2,807	75.7%	59	1.6%	11	0.3%	3,706
1998	681	18.6%	2,915	79.6%	59	1.6%	7	0.2%	3,662
1999	679	18.6%	2,915	79.7%	55	1.5%	7	0.2%	3,656
2000	220	17.5%	1,001	79.6%	30	2.4%	7	0.6%	1,258
2001	132	10.6%	1,088	87.1%	23	1.8%	6	0.5%	1,249
2002	201	9.8%	1,820	89.0%	18	0.9%	5	0.2%	2,044
2003	283	10.1%	2,492	89.2%	17	0.6%	3	0.1%	2,795
2004	329	13.1%	2,170	86.1%	17	0.7%	3	0.1%	2,519
2005	247	16.0%	1,281	83.1%	10	0.6%	4	0.3%	1,542
2006	199	14.0%	1,194	84.0%	22	1.5%	6	0.4%	1,421
2007	212	11.9%	1,538	86.4%	26	1.5%	4	0.2%	1,780
2008	195	9.5%	1,823	88.9%	29	1.4%	4	0.2%	2,051
2009 to date	53	6.1%	805	92.6%	10	1.2%	1	0.1%	869
Total	**10,178**	15.9%	**51,096**	80.0%	**2,352**	3.7%	**232**	0.4%	**63,858**

Banks improved their CRA performance over the years as they bolstered their efforts to make loans, investments, and services in low- and moderate-income communities. Yet, the low failure rate in recent years appears to be implausible. A study conducted by the Center for Community Capitalism concluded that CRA service test scores are likely to be inflated when low scores on the lending test and investment test confront banks with the possibility of CRA exam failure.[5] In addition, Rick Marsico in his book *Democratizing Capital* reveals how quantitative criteria are applied in an inconsistent manner on CRA exams, suggesting that a number of CRA exams have ratings that cannot be justified.[6]

The inflated ratings reduce the incentives banks have to maintain and increase their responsible lending, investing, and services in low- and moderate-income communities. If banks conclude that they will receive passing ratings regardless of fluctuations in their lending, investing, and service levels, they will not be motivated to maximize their resources and attention to their CRA performance. The agencies have not significantly changed their ratings methodology or ratings scale in several years to bolster the meaning and value of passing ratings. At the very least, the agencies could have introduced more gradations among the passing ratings in order to reveal more accurately distinctions in bank performance, which would be useful for the general public, religious and nonprofit institutions, and state and local agencies as they determine which banks are excelling on their CRA exams and reward them by placing deposits at their branches. Thus, the meaning and value of CRA ratings as a mechanism for motivating bank lending, investment, and services has not realized its full potential due to the staid, unimaginative, and lackadaisical approaches of the agencies.

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[5] Michael A. Stegman, Kelly Thompson Cochran, and Robert Faris, Center for Community Capitalism, University of North Carolina, *Creating a Scorecard for the CRA Service Test: Strengthening Basic Banking Services under the Community Reinvestment Act*, 2001. Also see the Woodstock Institute, *Measuring the Provision of Banking Services for the Underbanked: Recommendations for a More Effective Community Reinvestment Act Service Test*, March 2007. Of the 14 banks in Woodstock's sample with the highest scores on the service test, eight had branch distributions in low- and moderate-income communities that were well below the averages for all lenders as a groupin the banks' assessment areas

[6] Richard D. Marsico, *Democratizing Capital: The History, Law, and Reform of the Community Reinvestment Act*, Carolina Academic Press, 2005.

OTS Leads in Weakening CRA, and Other Agencies Follow Suit

Instead of enhancing CRA, the slow regulatory changes to CRA over the last several years have weakened CRA. In 2001, the agencies announced an Advanced Notice of Proposed Rulemaking (ANPR) asking the general public, banks, and community groups if any changes should be made to CRA. After several years of enforcing CRA, the agencies were either not bold or creative enough to propose any changes, but merely asked stakeholders for their opinions. Several comments from NCRC and our 600 member organizations about improving the rigor of CRA were cast aside. After a three-year lapse, the agencies announced proposals in 2004 to weaken CRA by reducing data disclosure requirements and exam rigor for mid-size banks. Then, in the summer of 2004, a dramatic split occurred among the four agencies. Three of the agencies withdrew their proposal to reduce CRA requirements for mid-size banks, while the OTS further weakened CRA requirements.

On July 16, 2004, the Federal Reserve issued a press release that acknowledged the detrimental effects of the proposed regulatory laxity for mid-size banks. The Federal Reserve press release states, "While community banks strongly favor…(the proposal), it is uncertain that the cost savings to the average community bank of being "small" rather than "large" under the proposal would be significant. On the other side, the proposal's cost in the form of a potential reduction in community development capital in a significant number of rural communities is also uncertain, but potentially large in at least some communities. On balance, the Board does not believe that the cost savings of the proposal clearly justify the potential adverse effects on certain rural communities." The OCC and FDIC agreed with the Federal Reserve Board's assessment and also withdrew the proposed changes on the same day.

Unfortunately, the OTS not only proceeded with the change discarded by the other three agencies, the OTS made the change even worse. In its press release on July 16, 2004, the OTS announced that it would apply the reduced CRA exams for even larger category "small" institutions. The proposal discarded by the FDIC, OCC, and Federal Reserve had raised the asset range of small institutions to $500 million; the OTS raised the asset range to $1 billion and applied the reduced exams to these institutions.

The OTS continued to undermine CRA by implementing watered-down exams for thrifts with assets above $1 billion. For these thrifts, their lending test would count for at least 50 percent of their overall CRA rating, but their investment and service tests could count for any percentage the thrift chose. In contrast, the banks with assets above $1 billion under the FDIC, Federal Reserve, and OCC jurisdiction had CRA exams in which the lending test counted for 50 percent of the overall rating while the investment and service tests each counted for 25 percent. The discretion over changing weights lowered the thrifts community development financing. In a study of the OTS' new weighting model, NCRC and New York Law School found that large thrifts examined under the old and new schemes reduced their level of community development lending and investment from $6.2 million to $5.7 million. In addition, the ratio of the annualized median total dollar of community development lending and investment to asset level of the thrift decreased from .48 to .33. That is, the median percentage of a thrift's assets in the form of community development loans and investments dropped by nearly one-third. Yet, at the same time, the large thrift ratings became inflated. Before the new weighting scheme, 40 percent of the thrifts in the study's sample (of 25 thrifts) had Outstanding ratings. After the new weighting scheme, 60 percent of the thrifts had Outstanding ratings. The overall effect of the OTS's change was grade inflation coupled with less community development lending and investing.[7]

In the spring of 2007, a new and a more pragmatic OTS director reversed the OTS's changes to CRA regulation and aligned the OTS regulation and exam procedures to those of the other agencies. Yet, the other three agencies felt pressured by the OTS to also weaken their regulations because they were caught up in a "regulatory competition." They were afraid that if the OTS's CRA rules remained significantly more lenient for all sizes of institutions, they may lose financial institutions to the OTS. In response to this, the agencies returned to their proposal to weaken CRA exams for mid-size institutions. Though they removed some of the worst aspects of their original proposal, they nevertheless relaxed CRA exam and data reporting requirements for mid-size institutions with assets between $250 million to $1 billion.

[7] Josh Silver, NCRC, and Rick Marsico, New York Law School, "An Analysis of the Implementation and Impact of the 2004-2005 Amendments to the Community Reinvestment Act Regulations: The Continuing Importance of the CRA Examination Process" in New York Law School Law Review, 2008-2009, Volume 53, Number 2.

One aspect of the laxity of CRA regulation was less attention to bank branches (though the exams were supposed to assess bank branches and services to low- and moderate-income communities). Before the changes to the mid-size exams, NCRC and New York Law School found that the 92 exams in our sample recorded the number of branches in low- and moderate-income neighborhoods 97 percent of the time. After the changes to the mid-size exams, the exams failed to record the number of branches in low- and moderate-income exams 32 percent of the time. In addition, 53 percent of the exams after the changes did not discuss the percentage or distribution of branches in low- and moderate-income neighborhoods. As payday lending and usurious fringe services have increased in low- and moderate-income neighborhoods, sensible public policy would be to increase emphasis on bank branches and the provision of affordable deposit and checking accounts in low- and moderate-income communities. Yet, a de-emphasis on branches is occurring in the case of mid-size banks, which are particularly important providers of services in smaller metropolitan areas and rural communities.

A final aspect of regulatory weakening was the deletion of small business and small farm loan data collection and reporting for the mid-size banks. In a report for the Appalachian Regional Commission, NCRC documents the important role of mid-size banks in providing small business loans, using the publicly available CRA small business loan data. Yet, we did not know when conducting the study that we were using the last year of the publicly available small business loan data for mid-size banks. It is likely that mid-size banks will not be as attentive to the credit needs of small businesses and small farms since the general public can no longer access their publicly available loan data showing how many loans they made to small businesses and farms in low- and moderate-income areas. In fact, the general public will never know for sure the impact of the deletion of the small business and farm reporting requirement since the deletion of the reporting requirement makes it impossible to compare lending trends of mid-size banks before and after the change.

The Case of Assessment Areas

NCRC believes that instead of diluting CRA exams and regulations, bank agencies could have taken constructive steps to bolster lending and investing by strengthening CRA exams and regulations. One of the most significant actions bank agencies could have taken was to reform the procedures regarding assessment areas or the geographical areas on CRA exams. The geographical coverage of CRA exams is critical because it determines the how much of the bank's lending and other financial activity is covered by CRA exams. The geographical locations covered by CRA exams generally consist of metropolitan areas or counties that contain bank branches. When Congress enacted CRA in 1977, banks received deposits and made loans through branches. While some banks still issue loans predominantly through branches, others make the majority of their loans through brokers and other non-branch means.

Though the CRA regulation stipulates that assessment areas include geographical regions containing bank branches, the regulation also states that assessment areas include other geographical regions in which the bank has originated or purchased a substantial portion of its loans.[8] Despite this regulatory clause, the federal agencies usually adopt a narrow definition of assessment areas for banks or thrifts that issue most of their loans through non-branch channels. For these banks, it is not unusual to encounter CRA exams that cover only the geographical area of the bank's headquarters.

In 2007, NCRC identified several lending institutions that engaged in questionable practices, including refusal to make loans under a minimum loan amount (usually $75,000 or $100,000), refusal to make loans to row homes, and failure to offer loans within entire cities. NCRC research revealed four banks engaged in these practices. In fact, only 11 percent to 13 percent of the loans investigated were in the banks' assessment areas.[9]

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[8] See Section 345.41 of the FDIC's CRA regulation available via http://www.fdic.gov/regulations/community/community/index.html
[9] Contact NCRC on 202-628-8866 for more information regarding our fair lending investigations.

Restricted assessment areas also motivate banks to locate their high-cost lending activities beyond assessment areas where they were not scrutinized by CRA exams. As previously stated, of all the high-cost loans issued in 2006, only 6 percent were made by banks to low- and moderate-income borrowers and neighborhoods in assessment areas and therefore considered on CRA exams. In contrast, 18 percent of all the high-cost loans were made by banks to low- and moderate-income borrowers and neighborhoods in geographical areas not on CRA exams. In other words, three times the amount of bank high-cost lending to low- and moderate-income borrowers and communities were in geographical areas not scrutinized by CRA exams than areas covered by CRA exams. If the geographical reach of CRA exams was extended, banks would likely make even fewer high-cost loans to low- and moderate-income borrowers.[10]

In addition to enabling problematic practices, narrow assessment areas defeat CRA's objective of banks responding to community needs. In one recent case, an NCRC member organization in Pennsylvania was concerned about the impact of a large bank merger on the bank's continued commitment to the organization's city. The newly merged institution would, in fact, be the largest lender (measured by number of home loans) in the city. Because the bank did not have a branch in the city and the city was not in a CRA assessment area, the bank declined to engage in substantive discussions about future collaboration or community development lending and investing. Although the bank had a major lending presence in the city, the bank was not encouraged by CRA exam procedures to see how it could meet credit needs beyond home lending in that area.

William Apgar and Ren Essene document the worrisome impacts of restricted assessment areas. They estimate that the share of home purchase and refinance lending covered by CRA exams fell from 40.6 percent in 1993 to 25.6 percent in 2006. Among CRA-covered banks, lending outside of assessment areas grew the fastest during this time period. For example, refinance lending by

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[10] Memo of November 21, 2008 to Sandra Braunstein, Director, Consumer and Community Affairs Division, from Glenn Canner and Neil Bhutta, subject Staff Analysis of the Relationship between CRA and the Subprime Crisis.

banks in their assessment areas increased by only 59 percent from 1993 to 2006 in contrast to a 334 percent increase by banks outside of their assessment areas.[11]

The response of the regulatory agencies to shrinking assessment area lending has been counterproductive. Although they engaged in a number of regulatory changes to CRA since 1995, they did not propose any adjustments to their assessment area procedures. Instead of rectifying assessment areas procedures, the agencies have increasingly proposed that certain bank community development activities outside of bank assessment receive favorable consideration on their CRA exams. This, however, is counterintuitive from a community development perspective since the prospects of community development succeeding in revitalizing communities is boosted when the community development is concentrated in geographical areas where banks lend and stimulate development in low- and moderate-income areas.

The OTS is the only agency that has taken marginal steps to address assessment areas since this agency oversees most of the non-traditional institutions lacking branch networks. OTS exams sometimes review lending trends in a sample of metropolitan areas outside of assessment areas, but these areas still constitute a minority of the non-traditional thrift lending.[12] Moreover, NCRC has not seen evidence of any significant consequences in the form of lower ratings when lending outside of assessment areas was not sufficient in reaching low- and moderate-income borrowers. Instead of the OTS half-measures, the agencies have had the authority to meaningfully expand assessment areas so that a majority of bank lending was considered on CRA exams. At the very least, the agencies could have emphatically raised this issue with Congress, but, to-date, have chosen not to do so.

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[11] Ren S. Essene and William C. Apgar, The 30th Anniversary of the Community Reinvestment Act: Restructuring the CRA to Address the Mortgage Finance Revolution in Revisiting the CRA: Perspectives on the future of the Community Reinvestment Act," a Joint Publication of the federal Reserve Banks of Boston and San Francisco, February 2009

[12] John Taylor and Josh Silver, "The Community Reinvestment Act at 30: Looking Back and Looking to the Future," in New York Law School Law Review, 2008-2009, Volume 53, Number 2.

The Agencies Fail to Adequately Utilize the Merger Application Process to Enforce CRA

In addition to a failure to adequately update CRA regulation, bank agencies have missed numerous opportunities to enforce CRA. The merger application process presents significant opportunities for federal agencies to enforce CRA. Yet, the enforcement of community reinvestment obligations through the merger application process has been lacking over the last several years.

In Congressional testimony in 2007, an official representing the Federal Reserve testified that the Federal Reserve has held only 13 public meetings on mergers since 1990. This is less than one meeting per year in an era in which consolidations have profoundly changed the banking industry. In addition, the Federal Reserve representative stated that since 1988, the Federal Reserve received 13,500 applications for the formation of banks or the merger of institutions involving bank holding companies or state-chartered banks that were members of the Federal Reserve System. Yet, only 25 of these applications were denied, with 8 of these denials involving consumer protection or community needs issues.[13] In addition, the Federal Reserve and the other agencies have had the authority to require specific improvements to CRA and fair lending performance when approving mergers. But the instances of the "conditional" approvals have declined significantly from the late 1990s; these conditional approvals occasionally occurred during the Clinton Administration but virtually disappeared during the Bush Administration.

The agencies also have not fully engaged the public in deliberations over mergers with profound impacts. In 2006, Wachovia acquired World Savings, the largest lender of exotic mortgages. However, there was no public hearing on this merger that posed significant fair lending and

[13] See http://www.federalreserve.gov/newsevents/testimony/braunstein20070521a.htm for Ms. Braunstein's testimony.

safety and soundness issues. In 2006, Regions proposed to take over AmSouth Bank; although this merger involved two of the larger banks in the South, the Federal Reserve declined to hold a public hearing in spite of the clear ramifications for the recovery of the Gulf States after Hurricane Katrina. The Federal Reserve also declined to hold a hearing on the merger of Bank of New York and Mellon although the Bank of New York had received low ratings on two of the three tests on their two most recent CRA exams.[14]

Most recently, the agencies declined to solicit the public's input regarding the emergency mergers involving JP Morgan Chase/Washington Mutual and Wells Fargo/Wachovia. If the agencies believed that the usual application process and public comment period was not possible in these cases, they could have held post merger meetings and public hearings as requested by NCRC member organizations. These mergers had significant impacts on lending and investing. For example, community organizations in the Western part of the country were concerned about JP Morgan Chase's commitment to continue successful affordable housing and community development initiatives of Washington Mutual. By demonstrating the seriousness of the CRA issues, formal agency involvement in these post emergency discussions would have facilitated mutually acceptable arrangements regarding CRA bank activities.

Fair Lending Enforcement Lacking

Current federal fair lending enforcement efforts have been inadequate to protect the interests of minority consumers and other protected classes. In September of 2005, the Federal Reserve Board stated that it referred about 200 lending institutions to their primary federal regulatory agency for further investigations based upon the Federal Reserve's identification of significant

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

pricing disparities in HMDA data.[15] An industry publication subsequently quoted a Federal Reserve official as stating that these lenders accounted for almost 50 percent of the HMDA-reportable loans issued in 2004.[16] In September of 2006, the Federal Reserve Board referred a larger number of lenders, 270, to their primary regulatory agencies for further investigations.[17]

Shockingly, not a single case of discrimination or civil rights violations have arisen from the roughly 470 Federal Reserve referrals. While the HMDA data analysis by itself cannot conclude which financial institutions were discriminating, it is inconceivable that Federal Reserve investigators could be so consistently inaccurate in their assessments about possible violations of fair lending laws during a time period of particularly abusive and usurious lending. When the HMDA data was not as detailed, the U.S. Department of Justice in the 1990s settled about a dozen cases alleging discrimination with major lenders, including Long Beach Mortgage and Huntington.[18] These settlements had industry-wide impacts, as lending institutions knew that the U.S. Department of Justice was serious about enforcing civil rights laws.

III. Rationale for Moving CRA to the CFPA

The current institutional structure has inhibited a fervent commitment to CRA and fair lending enforcement on the part of the agencies. Charter shopping, interagency conflict, competing regulatory priorities, and other institutional constraints have resulted in a CRA rulemaking and

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[15] Robert B. Avery, Glenn B. Canner, and Robert E. Cook, *New Information Reported under HMDA and Its Application in Fair Lending Enforcement*, Federal Reserve Bulletin, Summer 2005, http://www.federalreserve.gov/pubs/bulletin/2005/05summerbulletin.htm

[16] Inside Regulatory Strategies, November 14, 2005, p.2.

[17] Joe Adler, *Big Increase in Lenders with Suspect HMDA Data*, American Banker, September 11, 2006.

[18] There were a couple of cases in 2002 and 2004 (Mid America Bank, FSB, 2002; Fidelity Federal Bank, FSB, July 2002; First American Bank, July 2004), but these cases were before the new HMDA pricing information was available. The cases in the earlier years involved the Department of Justice versus Decatur Federal Savings and Loan, September 1992; Shawmut Mortgage Company, December 1993; BlackPipe State Bank, December 1993; Chevy Chase, FSB, August 1994; Huntington Mortgage Company, October 1995; Security State Bank of Pecos, October 1995; Northern Trust Company, 1995; First National Bank of Gordon, April 1996; Long Beach Mortgage Company, September 1996; First National Bank of Dona Ana County, January 1997; Albank, August 1997; Deposit Guaranty National Bank, September 1999.

enforcement record that ranges from lackluster to negligent. An objective analysis of the record does not produce compelling arguments for retaining CRA and fair lending enforcement with the current bank agencies. Instead, the same rationale for moving the enforcement and rulemaking for the other consumer protection and fair lending laws applies with the same vigor to placing CRA under the jurisdiction of the CFPA. The time is now to have an agency whose core mission is the protection of consumers and communities to oversee all of the consumer and fair lending laws.

Former Federal Reserve Governors testified last week that consumer protection and systemic risk should be overseen by separate regulatory agencies in order to most effectively utilize regulatory resources. "The skills and mindset required to operate as a consumer protection regulator is fundamentally different from those required by a systemic regulator," former Federal Reserve Governor Frederic Mishkin wrote in testimony for the House Financial Services Committee's Subcommittee on Domestic Monetary Policy. Mishkin continued, "A regulator charged with enforcing rules and managing systemic risk may end up devoting too much of its attention to rule enforcement."

Lawrence Meyer, another former Federal Reserve governor, said that "if something is to be given up (by the Federal Reserve System), the most obvious choice is consumer protection and community affairs (since)….These are not seen around the world as core responsibilities of central banks," he said.[19]

Placing all of the consumer protection and fair lending laws under the jurisdiction of the CFPA would maximize the ability of the CFPA to enforce the laws. The consumer protection and fair lending laws often reference each other, meaning that a violation of one of the laws is also a violation of another one of the consumer protection laws. If different regulatory agencies enforce these laws, opportunities will continue to be missed for effective enforcement since

[19] Steven Sloan, "Ex Fed Officials Back Paring Fed Role if It Gains Powers," Steven Sloan, Thursday, July 9, 2009.

different regulatory agencies have not regularly or routinely reported violation of laws to each other and thus have not jointly prosecuted practices that violate two or more laws.

Under CRA regulation, a violation of fair lending and anti-predatory law can also penalize a bank with a lower CRA rating if the violation of fair lending and anti-predatory lending law is widespread and substantial. Yet, if the current bank agencies retain the authority to conduct CRA exams, it is not guaranteed that the bank agencies will consult regularly with the CFPA to ascertain if any fair lending or anti-predatory violations have occurred that should impact on the CRA rating. If the bank agencies do not consult with the CFPA or conduct their own fair lending reviews, they will not develop a full understanding of the lending practices and patterns of the banks they are examining and thus will award ratings that will not fully reflect the banks' record of serving credit needs of all communities. The best way to avoid the possibility of inadequate consultation among agencies is to simply place both CRA and fair lending examination authority with the CFPA.

Arguments against Moving CRA to CFPA Are Not Convincing

Some stakeholders have recently testified before this Committee offering various arguments against moving CRA to the CFPA. These arguments involve the issues of safety and soundness, community development, and consumer protection. Each of these arguments is not convincing and can be easily addressed and rebutted.

<u>Safety and Soundness Argument a Red Herring:</u> Industry trade associations have asserted that placing CRA under the jurisdiction of the CFPA would divorce CRA enforcement from the examination of safety and soundness, which would remain with the federal bank agencies. The safety and soundness exams result in a CAMELS rating being issued to a bank, which is a rating from 1 to 5 of the overall condition of a bank. CAMELS is an acronym describing the exam elements: C- Capital Adequacy, A – Asset Management, M – Management, E- Earnings, L- Liquidity, and S – Sensitivity to Market Risks. Exams resulting in CAMELS ratings are

currently conducted separately from CRA exams and are confidential (the public does not see the rating which is shared between the regulatory agency and the bank).

CRA exams also consider safety and soundness issues but the consideration focuses on lending practices instead of the overall financial condition of the bank. If lending practices are abusive, illegal, and unsafe, the CRA exam is supposed to penalize a bank through a lower rating. An example of this is the FDIC's exam of CIT Bank of May 12, 2008. The FDIC failed this Utah-based industrial bank based on its purchases of predatory loans. Quoting from the FDIC's exam, "CIT Bank engaged in an unsafe and unsound practice by purchasing $3.1 billion in subprime nontraditional mortgage pools with predatory characteristics that resulted in a significant negative impact on the institution's overall CRA performance rating. The subprime nontraditional mortgage loans had undesirable characteristics including pre-payment penalties; stated income loans; and qualifying borrowers at a teaser rate, resulting in payment shock when scheduled resets ultimately occur. The characteristics of the underlying mortgage loans greatly increased the risk that the borrowers would default, or otherwise be in a worse financial position than they were previous to accepting the loan. CIT's purchase of the subprime mortgage pools was made in an unsafe and unsound manner that caused harm to consumers. In doing so, CIT failed in its responsibility to meet a basic tenet of CRA."[20]

As this example illustrates, transferring CRA, fair lending, and consumer protection oversight to CFPA would provide CFPA with the necessary examination tools to conduct similar analyses and ensure that CRA activities are conducted in a safe and sound manner. This skill set is distinct from those necessary to execute overall safety and soundness reviews that generate CAMELS ratings. In other words, these skill sets are significantly different and require separate

[20] FDIC CRA Exam of CIT Bank, May 12, 2008, Certificate Number 35575, available via http://www2.fdic.gov/crapes/2008/35575_080512.PDF, last accessed July 12, 2009. It is commendable that the FDIC took this action, but this is one of the few examples of adequate CRA enforcement by the agencies over the last eight years and occurred towards the tail end of the Bush Administration after the subprime lending crisis was in full bloom. It was also executed by an agency whose Chairman is one of the few examples of a regulatory leader over the last several years dedicated to consumer protection.

agencies to develop unique institutional expertise as recommended by former Governors Mishkin and Mayer.

Community Development Argument Specious: Ellen Seidman, former Office of Thrift Supervision Director during the Clinton Administration, the National Association of Affordable Lenders (an industry trade association), and a few other bank trade associations maintain that the CFPA should not oversee CRA because it would lack the expertise regarding community development. Community development refers to activities that revitalize the community as a whole such as financing affordable rental housing, community facilities such as health care clinics, and economic development including shopping centers. Seidman and others comment that since the CFPA would focus on the protection of consumers as individuals, that CFPA would not have the capacity to understand and encourage community development.

Seidman, however, undercuts her own argument by suggesting an institutional mechanism that would ensure that CFPA would acquire the necessary CRA and community development expertise. She recommends that should CRA be transferred to CFPA "there should be a statutory requirement for a separate division of the CFPA devoted explicitly to all parts of CRA, including in particular community economic development…" In fact, the Administration's proposal and H.R. 3126 take a step in this direction by creating a unit of community affairs that would provide guidance and technical assistance regarding the provision of financial products and "services to traditionally underserved consumers and communities." It is a straightforward matter to create the necessary divisions and institutional structures for establishing the expertise needed to conduct CRA exams and to motivate community development financing. Just as staff and expertise were shifted from the U.S. Department of Housing and Urban Development and the Office of Federal Housing Enterprise Oversight to the Federal Housing Finance Agency, the new regulatory agency overseeing Fannie Mae and Freddie Mac, so too can CRA-related staff be shifted from the federal bank agencies to CFPA.

False Dichotomy Between Consumer and Community Protection: Some have argued that since CFPA's mission will be to protect consumers, it is not well suited to enforce CRA, a law that requires that community credit needs be served. However, communities represent a collection of consumers so protecting and promoting responsible access to credit for communities is an extension of CFPA's mission to protect consumers. CRA requires that credit needs be met consistent with safety and soundness, which is consistent to the requirements of consumer protection laws against discriminatory or unfair and deceptive lending practices. Providing CFPA with jurisdiction to enforce both CRA and the other consumer protection laws would increase the effectiveness of the CFPA in enforcing all of these laws, which are complementary in nature.

Since the Bank Agencies Have Merger Approval Power, They Should Have CRA Responsibilities: While the Administration was correct in placing CRA under the jurisdiction of CFPA, its proposal was incomplete regarding merger applications. Because the Administration's proposal shifts CRA responsibility to CFPA but indicates that the bank agencies (such as Federal Reserve Board and the FDIC) must decide the outcome of merger applications, the bank agencies would be required to consider the CRA exams conducted by CFPA in their decisions on merger applications. Contrary to the Administration's proposal, Seidman suggests that since the existing agencies would decide merger applications, they should also conduct CRA exams. In contrast, NCRC recommends that bank agencies must be required to obtain the consent of CFPA before deciding the outcome of a merger application. Currently, these agencies have the authority to approve, deny, or require specific improvements to CRA and fair lending performance as part of a merger approval. The merger application process must also retain the same procedures for notifying the public when merger applications have been filed, which allows the public to obtain copies of the merger applications and provide comments to the regulatory agencies. NCRC recommends that CFPA issue a written opinion regarding the CRA and fair lending performance of banks as part of the merger application process, and that CFPA and the bank agencies hold public hearings and meetings with banks and those who have offered written comments on the merger application.

IV. CFPA's Effectiveness Would Be Bolstered If CRA Were Modernized

CFPA's effectiveness would be bolstered if CRA were updated as it was being shifted under CFPA's jurisdiction. CFPA would be more effective in leveraging increases in responsible loans and investments if CRA were strengthened as applied to banks, if CRA were applied to non-bank financial institutions, and if the publicly available data on financial institution lending, investing, and services were enhanced. Both the Administration's proposal and H.R. 3126 are particularly strong regarding enhancing data disclosure. The Administration's proposal and H.R. 3126 recognize that data enhancements are critical to promoting access to responsible credit and financial services, identifying business and community development opportunities, and promoting adherence to the fair lending and consumer protection laws.

Enhancements to Data Disclosure

The Administration's proposal and H.R. 3126 include the following critical enhancements to data disclosure:

Collection of Deposit Account Data

Banks and credit unions would be required to maintain and disseminate data on their branches, ATMs, and other depository facilities, as well as maintain and disseminate the census tract locations of their depository facilities. (Note: Deposit accounts include checking, savings, credit union share accounts and other types of account as defined by CFPA.) The number and dollar amount of deposit accounts for the residential and commercial customers for each deposit facility would also be collected. The place of residence/business of bank/credit union customers would be provided on a census tract basis, making it possible to analyze the income level and race/ethnicity percentage of the census tracts of these customers. These data should be used as part of CRA exam analysis as proposed by the Administration.

Small Business Loan Data Collection

Financial institutions would be required to collect Home Mortgage Disclosure Act (HMDA)-like data on small businesses to determine whether a business is minority- and/or women-owned. In addition to collecting race and gender data, the financial institution would be required to collect the type and purpose of the loan for which the business is applying, the type of action taken with respect to the application, the gross annual revenue of the small business, the census tract location of the business, and any other information CFPA deems appropriate.

Financial institutions that would be required to collect and report these data include any partnership, company, corporation, and cooperative organization. This requirement extends beyond banks that have a current obligation to report small business loan data under CRA. CFPA does, however, reserve the right to exempt any class of financial institutions from this reporting requirement.

The importance of this data cannot be understated. The addition of race and gender data in HMDA facilitated a dramatic expansion of prime lending to minorities and women in the 1990s before the explosion of subprime lending from 2003-2007. For example, home lending to African Americans and Hispanics increased 79.5 percent and 185.8 percent, respectively, compared to 51.4 for middle- and upper-income borrowers 1993 and 2002.[21] In contrast, a well-developed literature based on national surveys indicates the likely possibility of discrimination against women- and minority-owned small businesses.[22] A lack of publicly available data on small business lending by race and gender has inhibited lending to women- and minority-owned businesses by preventing stakeholders from identifying missed opportunities to serve minority- and women-owned businesses and by enabling discriminating lenders to remain undetected when violating the fair lending laws.

The Federal Reserve Board has inhibited rather than facilitated the promotion of additional data collection of small business lending. The Federal Reserve has prevented lenders from voluntarily collecting race and gender data for small business borrowers by failing to lift the

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[21] See NCRC's CRA Toolbox via http://www.ncrc.org/images/stories/supportNCRC/ncrc_craoverview.pdf.
[22] NCRC report for the Appalachian Regional Commission, Access to Capital and Credit for Small Businesses in Appalachia, May 2007, http://www.ncrc.org/images/stories/mediaCenter_reports/ncrc%20study%20for%20arc.pdf

current prohibition in Regulation B (that implements the Equal Credit Opportunity Act) against collecting this data. In addition, the Federal Reserve discontinued the periodic national survey that enabled researchers to document disparities and likely discrimination in small business lending. In total, the Federal Reserve's actions discouraged debate and discussion on small business data disclosure, which is inconsistent for an agency that has been responsible for enforcing CRA and the fair lending laws. This is yet another reason to shift CRA enforcement to CFPA.

Enhancements to Home Mortgage Disclosure Act (HMDA) Data

In addition to the demographic characteristics they already collect in HMDA data, financial institutions would be required to collect the age of the borrower under the Administration's proposal and H.R. 3126. NCRC and others have found that elderly borrowers experience lending disparities; this additional data element will allow for a more systematic investigation of these disparities. Several loan terms and conditions would also be collected, including total points and fees, the difference between the annual percentage rate and a benchmark rate for all loans, prepayment penalties, the value of the real property pledged as collateral, whether the loan is a hybrid loan with a lower teaser rate, whether the loan is a negative amortization loan, whether the application was received by a broker or other retail channel, and the credit score of the borrower.

NCRC Recommendations for Expanding and Modernizing CRA

H.R. 3126 and the Obama Administration's legislative draft for the CFPA are particularly strong regarding disclosure data requirements. Yet, the other major elements of CRA modernization including strengthening CRA as applied to banks and expanding CRA to non-bank financial institutions is absent from the Administration's proposal and H.R. 3126.

The following is a description of the critical elements of CRA modernization that are not in the Administration's plan. The Community Reinvestment Modernization Act of 2009 (H.R. 1479) contains critical elements for expanding and modernizing CRA.

Strengthen CRA as Applied to Banks

CRA should be updated so that the great majority of loans that banks make are scrutinized by CRA exams. Currently CRA examines banks in geographical areas where they have branches but not in other areas where they lend through brokers. Consequently, CRA exams of many large banks only scrutinize a minority of the banks' loans. In addition, a bank has the option of including its affiliated mortgage company on its exam. NCRC has found that mortgage company affiliates not included on bank exams engaged in redlining, such as refusing to lend to row homes. Existing loopholes (primarily examining loans made through branches and optional inclusion of mortgage companies) lead to inconsistent enforcement that fails to detect and eliminate abusive practices. While the assessment area issue could probably be remedied by a regulatory agency dedicated to CRA enforcement, the surest fix is statutory language such as that in H.R. 1479. Moreover, statutory authority is necessary regarding applying CRA to mortgage company affiliates of banks.

Expand CRA to Non-bank Financial Institutions

CRA should be expanded to cover non-bank financial institutions. Independent mortgage companies, investment banks, and other non-bank institutions engaged in high volumes of risky lending that ended up in foreclosure and led to the financial collapse. Had CRA been applied broadly throughout the financial services industry, the foreclosure crisis could have been averted, as CRA mandates responsible lending and investing.

Mandate Additional Enforcement Mechanisms beyond Merger Applications

NCRC believes that CRA needs additional enforcement mechanisms beyond the merger application process. One enforcement mechanism involves requiring banks to submit improvement plans subject to public comment and federal agency approval if a bank has a low CRA rating in any geographical areas on their CRA exams. H.R. 1479 would expand the number of geographical areas receiving ratings to include metropolitan areas and rural areas (currently ratings are assigned on a state-wide level and for multi-state metropolitan areas that cross state borders). H.R. 1479 would also increase the number of possible ratings so as to make ratings more meaningful as discussed above. By increasing the number of geographical areas that are graded and requiring improvement plans for any area receiving a low rating, H.R. 1479 would increase bank attention to and therefore bolster bank CRA performance in medium-sized cities and rural areas, as well as their larger markets.

In extending CRA to insurance companies and mortgage companies, H.R. 1479 prevents loans from being sold to Fannie Mae and Freddie Mac if the insurance company and mortgage company involved with the loans failed its CRA exam and then did not submit a satisfactory improvement plan. This requirement should also be extended to banks.

NCRC recommends that Congress consider establishing a private right of action to enforce CRA. Community organizations and individuals would have a right to bring actions to a court of law if they could prove that CFPA and prudential regulatory agencies failed to adequately examine a bank under CRA, or adequately consider consumer protection and CRA factors in a merger application (Note: This is not a current provision of H.R. 1479).

Race as a Factor on CRA Exams

As beneficial as CRA has been to communities over the years, its coverage is incomplete. Specifically, the CRA regulation requires examiners to measure lending, investing, and services to low- and moderate-income communities and borrowers, but not to minorities and minority communities. If CRA explicitly considered lending to minorities, prime or market-rate lending to minorities would increase since banks are primarily prime lenders. Banks would be motivated to increase their responsible lending to minorities since their CRA exams would now assess their performance in serving minorities and communities of color. Product choice would also increase in minority neighborhoods and racial disparities in lending would be reduced.[23] H.R. 1479 would require CRA exams to explicitly scrutinize lending, investing, and branching/bank services to minorities and communities of color. H.R. 1479 also strengthens the sanction of lower CRA ratings for making or financing abusive loans that exhibit steering.

[23] For additional information on racial disparities in lending, see NCRC "Income Is No Shield, Part III: Assessing the Double Burden: Examining Racial and Gender Disparities in Lending," June 2009.

Additional Data Elements

H.R. 1479 requires the creation of a loan performance database that tracks delinquencies, foreclosures, and loan modifications (the Administration's proposal does not have this requirement). In addition, NCRC recommends that the Administration and Congress consider augmenting the CRA data on community development to include the census tract location of community development loan data and require a similar disclosure for community investment data. The purpose of community development lending and investment (such as affordable housing or small business development) should also be disclosed. NCRC also recommends that the enhancements that the Administration proposed regarding race, gender, and other data elements also be extended to small farm loan disclosure (Note: The recommendations about community development and small farm data are not in H.R. 1479).

V. Conclusion

The strongest consumer protection laws still do not amount to much if they are not vigorously enforced. Instead of a sheriff, the existing bank agencies are more like the Keystone cops, occasionally flailing their nightsticks but not coming close to capturing the predatory actors. The bank agencies have not displayed a sustained commitment to CRA enforcement nor have they been timely in updating CRA as the industry has changed. Their CRA enforcement record has fluctuated from mediocre to dismal. It is time that CRA enforcement is transferred to a new agency dedicated to protecting consumers and communities.

The placement of CRA in CFPA establishes a solid foundation for CRA modernization. As CRA is applied to different types of non-bank financial institutions, it would make more sense for one agency to conduct CRA exams than spreading this responsibility to even more agencies. CFPA could apply and adapt its experience in enforcing CRA for banks to other types of financial institutions. Institutional knowledge of the most effective ways to apply CRA is most effectively accumulated in one agency as CRA is applied to additional institutions.

Further, placing CRA under the jurisdiction of CFPA is the most effective means to utilize synergies among consumer protection laws. CRA enforcement also depends on the enforcement of fair lending and anti-predatory lending laws. One agency devoted to consumer protection can most effectively utilize all these laws for holding financial institutions accountable for serving communities in a responsible manner than several agencies with competing missions and priorities.

NCRC urges this Committee to reinstate CRA oversight with CFPA, to preserve and strengthen the data disclosure enhancements in H.R. 3126, and to graft H.R. 1479 (the Community Reinvestment Modernization Act of 2009) onto H.R. 3126. If the Congress adopts this course, our communities will benefit from an exponential increase in responsible lending and investing, recovery from the current recession will be expedited, and a looming foreclosure crisis will be averted. The time to act boldly is now.