NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

CRA Promotes Safe and Affordable Lending:

An NCRC Refutation of Another Baseless Attack on CRA

Once again, critics are spreading false information about the Community Reinvestment Act (CRA). A recent paper, "Did the Community Reinvestment Act Lead to Risky Lending?" by Sumit Agarwal and colleagues, incorrectly asserts that CRA contributed to risky lending with higher defaults.[1] This study is completely riddled with methodological flaws and errors and must not be used for any serious policy purpose.

The Community Reinvestment Act is a law that serves to increase responsible lending, investments, and services for low- and moderate-income communities. Passed by Congress in 1977, CRA requires banks to serve the convenience and needs of communities "consistent with the safe and sound operation of such institutions." Federal bank agencies rate banks on their lending, investing, and services in low- and moderate-income communities. The agencies are required to consider CRA performance when deciding whether to approve bank applications to merge or acquire other banks. A low CRA rating can result in denials of bank merger applications (very rare) or approvals with specific conditions for improvements in CRA and fair lending performance (occasional).

Benefits of CRA

Since the CRA statute explicitly requires safe and sound operations, it is not surprising that CRA has promoted safe and sound lending as documented by extensive research. Elizabeth Laderman and Carolina Reid of the San Francisco Federal Reserve Bank document that loans made by banks in their CRA assessment areas (geographical areas on CRA exams) are about half as likely to end up in foreclosure as loans issued by independent mortgage companies.[2] Likewise, Traiger & Hinckley LLP found that as bank branches increase, foreclosures decrease across metropolitan areas. Traiger & Hinckley suggests that banks were carefully underwriting loans originated from

[1] Sumit Agarwal, Efraim Benmelech, Nittai Bergman, and Amit Seru, Did the Community Reinvestment Act (CRA) Lead to Risky Lending? via http://ssrn.com/abstract=2172549.

[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

their branches because CRA exams were scrutinizing these loans.[3] Finally, the UNC Center for Community Capital found that prime loans originated between 2003 and 2006 through a CRA-motivated program were significantly less likely to be in default than were subprime loans made to borrowers with similar income and risk profiles.[4]

In a letter to Senator Robert Menendez, Federal Reserve Chairman Ben Bernanke wrote that CRA was not "at the root of, or otherwise contributed in any significant way to, the current mortgage difficulties," based on 30 years of Federal Reserve experience of CRA and research.[5] Federal Reserve economists found that only 6 percent of risky subprime loans were originated by banks and considered on bank CRA exams.[6]

Moreover, CRA, contrary to critics' assertions, is not only concerned with mortgage lending, and does not push banks to aggressively focus on mortgage lending. CRA requires banks to meet a plethora of needs and has resulted in significant amounts of lending and investing for rental housing, small business development, and support for community facilities. Since 1996, banks have reported more than $764 billion small business loans in low- and moderate-income communities. They have also made more than $602 billion in community development lending.[7]

CRA's impact is felt in rural communities as well as large cities. An NCRC report "Access to Capital and Credit for Small Businesses in Appalachia," showed that every two years banks issued $5.4 billion in community development lending and investing in Appalachia. Small business lending was higher in Appalachian counties with higher numbers of bank branches, demonstrating that bank branches had a positive impact on community lending.[8] Likewise, Zinman found that the reforms that strengthened the CRA regulations in 1995 increased bank small business lending and that lending increased to a greater extent in regions of the country with more rigorous CRA exams. Moreover, the CRA-related lending was just as profitable as non-CRA lending and did not "crowd out" or reduce the banks' other non-CRA lending.[9]

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[3] Traiger and Hinckley, LLP, "The Community Reinvestment Act: A Welcome Anomaly to the Foreclosure Crisis," January 7, 2008, and the addendum to the report, January 14, 2008.
[4] Carolina Reid with Mark A. Willis, Ellen Seidman, Lei Ding, Josh Silver, and Janneke Ratcliffe, Debunking the CRA Myth – Again, January 2013 (http://www.ccc.unc.edu/abstracts/debunkingCRAMyth.php)
[5] Chairman Bernanke's letter to Senator Menedez, November 2008, http://www.menendez.senate.gov/pdf/112508ResponsefromBernankeonCRA.pdf.
[6] Glenn Canner and Neil Butta, Federal Reserve Memorandum, Staff Analysis of the Relationship the CRA and the Subprime Crisis, November 21, 2008.
[7] NCRC calculations using CRA data from the Federal Financial Institutions Examination Council (http://www.ffiec.gov).
[8] Access to Capital and Credit for Small Businesses in Appalachia, NCRC report for the Appalachian Regional Commission, 2007, available via http://www.arc.gov/research/researchreportdetails.asp?REPORT_ID=8.
[9] Jonathan Zinman, *The Efficacy and Efficiency of Credit Market Interventions: Evidence from the Community Reinvestment Act*, July 2002 (CRA02-2), published by the Joint Center for Housing Studies of Harvard University.

Critique of Agarwal Paper

Agarwal and colleagues conclude that lending levels are elevated and default rates increase in home lending three quarters before and after a CRA exam. Their thesis is that banks are motivated to impress their examiners by boosting their lending shortly before CRA exams and even after the exam start date (presumably asking examiners to consider new lending after the start of the exam).

The basic problem is that the authors do not understand how CRA exams work and choose the incorrect time period. This is illustrated by the Manufacturers and Traders (M&T) CRA exam. M&T is a large bank with approximately $68 billion in assets at the time the Federal Reserve Bank of New York conducted their CRA exam. The exam was dated May 2010 and used 2009 and 2008 Home Mortgage Disclosure Act (HMDA) data for the analysis of the bank's efforts to make home loans to low- and moderate-income borrowers.[10] Firstly, the exam did not consider 2010 data so the authors are incorrect about using data after the exam start date. Secondly, three quarters before the exam date would be the time period between September 2009 and May 2010. CRA exams do not use quarterly data so the exam did not specifically scrutinize the time period between September and December 2009. Moreover, the 2009 data analysis was cursory since the Federal Reserve Bank of New York did not have the industry-wide data to compare with 2009 M&T data (the Federal Financial Institutions Examination Council usually releases the previous year's data for the entire industry, 2009, in this case in September of the following year, which is after the exam start date). M&T's exam has detailed comparisons of M&T's data with the industry-wide data for 2008 only.

In short, banks do not gain anything from trying to "game" the exam and increasing their lending shortly before and after an exam. A paper authored by Carolina Reid, Assistant Professor at the University of California at Berkeley with contributions from NCRC and others looks at 20 other CRA exams and similarly finds that the authors' quarterly assumption is incorrect.[11]

The authors also make a fundamental error in not restricting their data to accurately capture loans that would be considered on CRA exams. CRA exams consider bank lending in geographical areas called assessment areas, which are usually counties or metropolitan areas containing bank branches. The authors do not restrict their sample of CRA exam-related lending to assessment areas, which is a significant error because they include bank lending not scrutinized by CRA

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[10] Federal Reserve Bank of New York CRA exam of Manufacturers and Traders Trust Company, May 2010, available via http://www.newyorkfed.org/banking/cra_pes/2010/M&T_CRA_PE.pdf.

[11] See Carolina Reid, et. al, Debunking the CRA Myth – Again, (http://www.ccc.unc.edu/abstracts/debunkingCRAMyth.php)

exams. In addition, the authors do not restrict their sample of CRA-related lending to affiliates that the banks elect to have considered by CRA exams. Banks have the option of including or excluding their affiliates on CRA exams. Past research has shown that bank lending in their CRA assessment areas, including only affiliate loans that are counted by the bank, is of higher quality than bank loans outside of CRA assessment areas.[12] This makes sense since banks are most careful with their loans that they know will be examined.

By missing these important controls of assessment areas and affiliates, the authors are polluting the findings by including a significantly larger sample of loans as CRA-related loans. The result is likely to make CRA lending appear to be of a lower quality than it actually is. The authors report that their most robust findings are during the 2004 through 2006 time period, meaning that they are most likely capturing the overall decline in lending quality during that period of unregulated and careless lending than the impacts of CRA exams.

Glaring inaccuracies in the authors' data cast additional doubt on their findings. The authors report five CRA ratings for banks when, in fact, banks can only receive four overall ratings (Outstanding, Satisfactory, Needs-to-Improve, and Substantial Noncompliance). Perhaps the authors are confusing the overall ratings with component tests ratings, which do include the possible rating of Low Satisfactory. They further report that 84 percent of the banks in their sample received Low Satisfactory ratings. Again, perhaps, the authors meant the Lending Test of the CRA exam since Low Satisfactory is a possible rating on the lending test, but their finding of 84 percent of banks scoring Low Satisfactory is far too high. In an upcoming report for the Appalachian Regional Commission, NCRC calculates that just 18 percent of large banks located in Appalachia received Low Satisfactory on their lending test during their most recent CRA exams.

Clearly, CRA and fair lending policy cannot be based on this flawed paper. Instead, CRA policy should be based on the overwhelming majority of research that finds benefits associated with a law that requires banks serve communities with safe and sound lending.

CRA Reform

Previous legislative proposals point towards sensible and long overdue reforms to CRA. Introduced by Representatives Eddie Bernice Johnson (D-TX) and Luis Gutierrez (D-IL), H.R. 1479, the Community Reinvestment Modernization Act of 2009, strengthens CRA as applied to banks by expanding assessment areas or the geographical coverage of CRA exams. This would ensure that the great majority of loans issued by banks are scrutinized on CRA exams. The bill

[12] See Carolina Reid, et. al, Debunking the CRA Myth – Again.

would require CRA exams to evaluate an institution's lending in geographical areas where they provide loans through brokers, correspondents, or through the internet in addition to scrutinizing loans through branch networks.

Towards the end of the 111th Congress, Representative Gutierrez, Representative Maxine Waters (D-CA), Representative Al Green (D-TX), and Representative Johnson introduced H.R. 6334, the American Community Investment Reform Act of 2010. Like H.R. 1479, H.R. 6334 would also apply CRA to a variety of non-bank institutions including independent mortgage companies, mortgage company affiliates of banks, and securities firms. If these non-bank institutions had been subject to CRA requirements sooner, the foreclosure crisis would have been less severe because CRA requires institutions to serve communities in a manner consistent with safety and soundness. In addition, applying CRA to a large segment of the financial industry would increase responsible lending and investment in communities by hundreds of billions of dollars.

Lastly, the changes to the HMDA data mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 will improve the rigor of CRA exams. Dodd-Frank requires the agencies to include loan terms and conditions in HMDA data and to publicly release loan performance data including defaults and delinquencies. CRA examiners will be able to precisely exam loan safety, affordable, and sustainability. This will improve the rigor of CRA exams and heighten responsible lending in traditionally underserved communities.

In conclusion, it is time to finish the business of strengthening CRA and promote economic recovery in all communities rather than being distracted by another baseless attack on a critical law for neighborhoods.