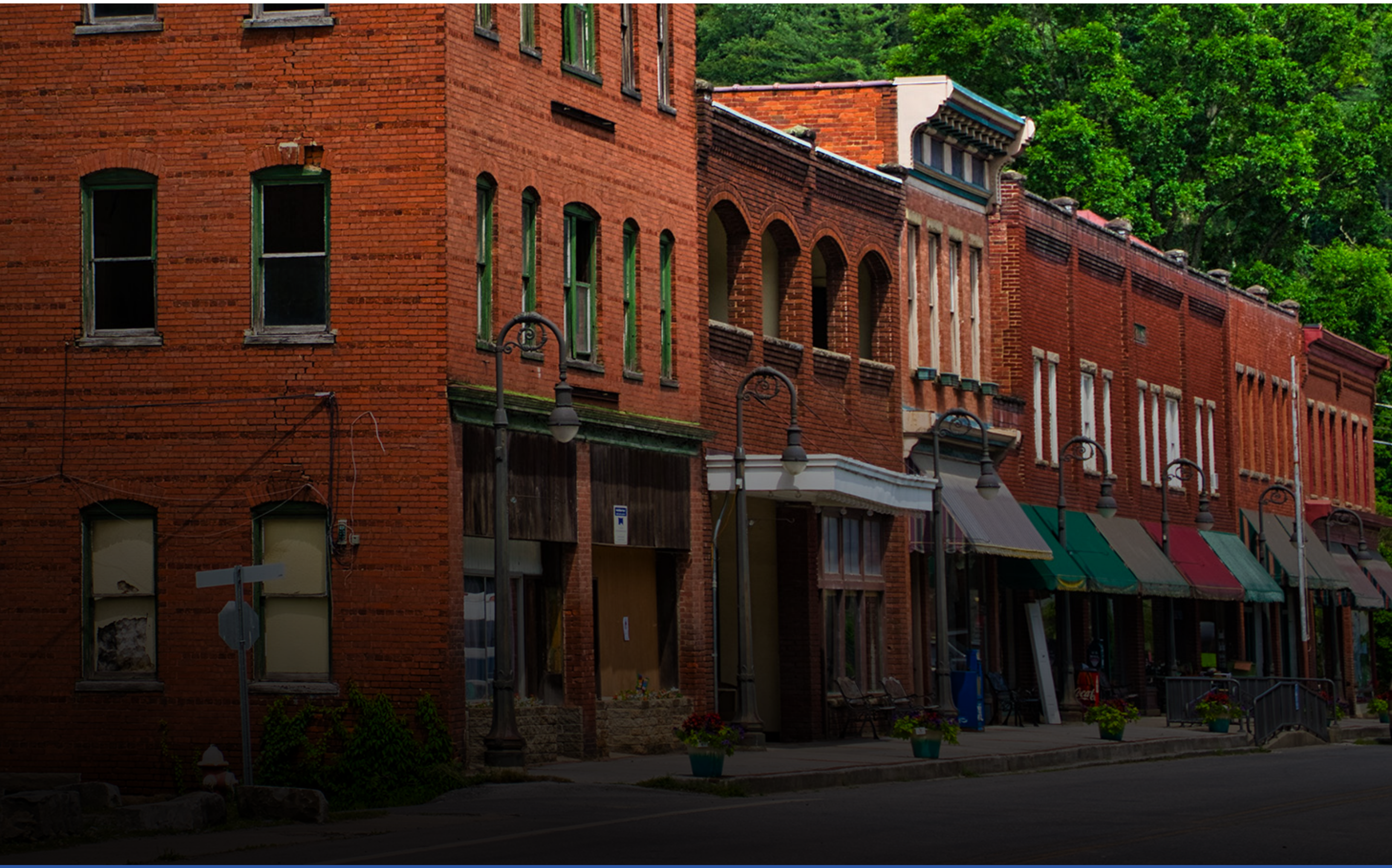
National Community Reinvestment Coalition

Making CRA Relevant for a Changing Financial Services Industry

Bruce C. Mitchell, Ph.D., Senior Research Analyst, NCRC
Josh Silver, Senior Advisor, NCRC



About NCRC

NCRC and its grassroots member organizations create opportunities for people to build wealth. We work with community leaders, policymakers and financial institutions to champion fairness in banking, housing and business.

Our members include community reinvestment organizations, community development corporations, local and state government agencies, faith-based institutions, community organizing and civil rights groups, minority and women-owned business associations, and social service providers from across the nation.

For more information about NCRC's work, please contact:

Jesse Van Tol
Pesident & CEO
jvantol@ncrc.org
(202) 464-2709

Jason Richardson
Director, Research & Evaluation
jrichardson@ncrc.org
(202) 464-2722

Andrew Nachison
Chief Communications and Marketing Officer
anachison@ncrc.org
(202) 524-4880

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Key Takeaways

- Households have dramatically reduced the amount of wealth kept in bank deposits, and increased the amount in securities, since the inception of the Community Reinvestment Act in 1977.
- Banks hold less consumer debt than they did in the past.
- Mortgage companies have displaced banks as the primary source for mortgage loans.
- The diversification of the financial sector with the rise of nonbanks, and the benefits they receive from federal government support, suggests that Community Reinvestment Act obligations should be applied broadly throughout the financial industry.

Executive Summary

This paper examines shifts in the market share of banks and nonbank financial institutions in important product markets. Banks are covered by the Community Reinvestment Act (CRA) which requires them to serve all communities, including low- and moderate-income (LMI) ones. Nonbanks, in contrast, do not have this obligation.

Because nonbanks have significantly increased their market share in key products, the ability of CRA to ensure access to credit and capital in LMI communities will decline if CRA is not expanded to nonbanks. The securities industry now holds a higher share of household savings or wealth than banks. Independent mortgage companies have a higher market share of home loans than banks. The situation in consumer lending markets is more nuanced with banks holding onto their market position but fintech technology companies are likely to continue chipping away at bank market share. Finally, Fannie Mae and Freddie Mac have a higher share of outstanding mortgage debt than banks.

This paper discusses why and how to apply robust CRA or duty to serve requirements broadly throughout the financial industry. It reviews previous and current bills introduced in Congress that would apply CRA to securities companies and mortgage companies. It also discusses proposals for regulatory reform that would strengthen CRA and the obligations imposed on Fannie Mae and Freddie Mac, which would increase lending in underserved communities.

Introduction

In 2007, the 30th anniversary of the passage of the Community Reinvestment Act (CRA) prompted several studies and white papers proposing the restructuring of the legislation. Much had changed in the regulation of financial markets and in the structure of the banking sector since CRA had been signed into law by President Carter in 1977. The changes have broad implications for how US households access credit and financial services and how community development is financed. They also raise policy questions about the efficacy of a CRA law focused exclusively on the nation's bank depositories to achieve the law's larger financial inclusion goals. Now, as the 45th anniversary of the passage of CRA approaches, renewed consideration of the law is necessary to account for profound changes in the financial services industry. Given the market shift toward nondepositories and other financial institutions that also receive significant benefits provided by the government, should more institutions have a commensurate obligation to ensure that their loans, investments and financial services are being provided equitably and serving low- and moderate-income (LMI) families and communities?

Several events caused Congress to initiate changes to CRA during the 1980's and 1990's. The savings and loan crisis of the 1980's motivated passage of the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) in 1989. The Riegle-Neal Interstate Banking and Branching Act of 1994 eased restrictions on interstate banking, and in 1999, the Gramm-Leach-Bliley Act repealed sections of the Glass-Steagall Act of 1933, removing the barriers between banking, investment and insurance services. While FIRREA and Riegle-Neal enhanced the public transparency and community accountability of the bank CRA evaluation process and ensured the law remained community-focused,[1] neither these nor other laws have addressed the substantial growth of nondepositories and other non-CRA regulated institutions. These institutions provide financial services akin to banks and receive benefits from participation in the Federal Reserve System, yet have no CRA obligations. Subsequent attempts to modernize or change the regulatory enforcement of CRA resulted in minor modifications that were almost exclusively applicable to banks. Because of this, CRA has applied to a declining share of the nation's loans, investments and financial services, reducing its effectiveness over time.

Changes in the mortgage market over the past two decades provide a cogent example of the weakened impact of CRA due to market changes. Research by Essen and Apgar found that the proportion of residential mortgage loans under CRA had continued to decline, as

1 Remarks by Martin J. Gruenberg, Member, Board of Directors, Federal Deposit Insurance Corporation on The Community Reinvestment Act: Its Origins, Evolution, and Future at Fordham University, Lincoln Center Campus; New York, New York, October 2018, https://www.fdic.gov/news/speeches/2018/spoct2918.html

changes in the law and lending markets facilitated the growth of nonbank market share.[2] Because CRA compelled banks to overcome the informational externalities and barriers in formerly redlined communities and do more business in these communities, other non-CRA lenders had an easier time entering LMI markets.[3] Another paper by Avery, Courchane and Zorn emphasized the impact of deregulation on the consolidation of banks into larger institutions, the development of national level credit repositories and the growth of the secondary mortgage market. In particular, the growth of Fannie Mae and Freddie Mac and the secondary mortgage market facilitated the emergence of non-CRA covered mortgage companies as a major presence in lending markets.[4]

Both of the papers made extensive use of data from the period 1977 to 2007, which encompassed the era prior to the collapse of mortgage-backed securities and global financial crisis, precipitating the Great Recession of 2007-2009. The focus of this paper will be on Avery et al.'s work, updating some of this work and examining changes since 2007 by utilizing the Federal Reserve flow of funds reports and mortgage lending data collected under the Home Mortgage Disclosure Act (HMDA).

The research questions were:

1. Have household use of savings and lending vehicles provided by nonbank financial services companies continued to grow?
2. Have nonbank lenders continued to increase the share of consumer debt they hold relative to CRA-covered depository institutions?
3. Have nonbank lenders increased their share of the home loan market and the outstanding mortgage debt relative to CRA covered depository institutions?

2 Essene, R. S., & Apgar, W. C. (2009). *The 30th anniversary of the CRA: Restructuring the CRA to address the mortgage finance revolution. Revisiting the CRA: Perspectives on the future of the Community Reinvestment Act,* 1-18. https://www.frbsf.org/community-development/files/30th_anniversary_cra1.pdf

3 Before CRA, financial institutions were not knowledgeable about the creditworthiness of neighborhood residents in redlined communities because they had not taken the time to consider their applications. Moreover, they did not have knowledge of the condition and quality of the housing stock or the neighborhoods. Over a number of decades, these informational barriers decreased as CRA required banks to meet the credit needs of these communities and seek out business in them.

4 Avery, R. B., Courchane, M., & Zorn, P. M. (2009). *The CRA within a changing financial landscape.* Available at SSRN 1374873. https://www.frbsf.org/community-development/files/cra_within_changing_financial_landscape1.pdf

FINDING 1: Bank deposits have declined as a percentage of household assets

The first topic in Avery et al.'s 2009 reassessment of CRA explored changes in household savings and credit behavior because CRA obligations are tied to consumer deposits in banks. In the late 1970's, about 25% of household assets were deposited in banks or savings and loan institutions which are subject to regulation under CRA. At that time, there were much lower percentages of household assets held in stocks - only 11% to 12% (Figure 1). This began to change in the 1980's, as a wider selection of deposit-type vehicles from non-CRA-regulated institutions such as money-market accounts became available. Households also switched to nondeposit type vehicles as the restrictions on only nonpension holder investment in individual retirement accounts (IRA's) were lifted. The extended economic expansion of the 1990's saw substantial increases in household ownership of both directly and indirectly held stocks until 1999, after which there was a precipitous drop related to the collapse of the dot-com bubble, the September 11, 2001, attacks, and then the "Great Recession."

Deposits and Stocks as a Percent of Household Assets

Figure1: Percentage of household assets held as deposits in CRA regulated institutions, and as directly and indirectly held stocks.

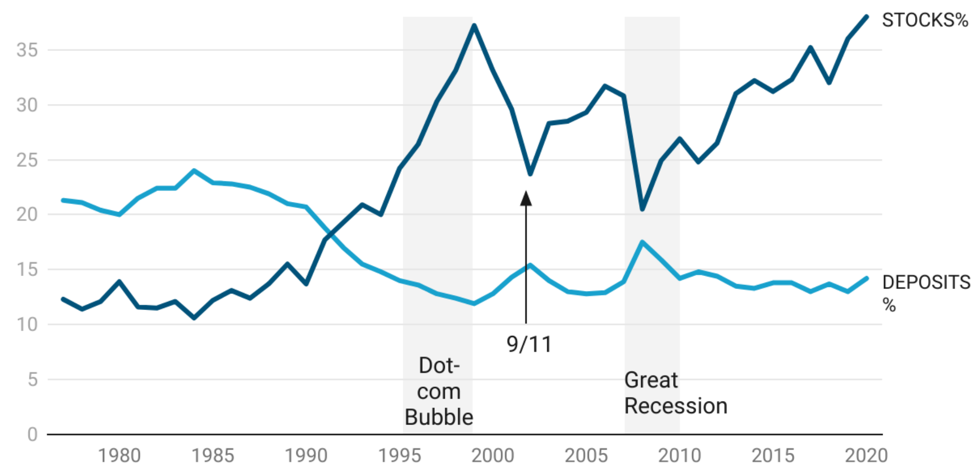


Chart: NCRC • Source: Board of Governors of the Federal Reserve System • Created with Datawrapper

Figure1: (Source: Board of Governors of the Federal Reserve System, Flow of Funds data: https://www.federalreserve.gov/releases/z1/default.htm)

Since the analysis by Avery et al. ended with 2007 data, the effects of the Great Recession were just being felt. Subsequently, the amount of assets held as deposits by households stabilized at 13-14%. Meanwhile, stock ownership rebounded to exceed levels of the late 1990's. In 2020, 38% of the assets held by all households nationally were held as stocks

(Figure 1). This underscores the shift in household holdings and savings behavior from deposits in banks to nondeposit-type vehicles offered by institutions not covered by CRA.

In its original conception, CRA placed obligations on banks that extended to their activities within their assessment areas, which are usually geographical areas where bank branches are located. However, the distribution of household assets has changed so that a lower percentage of assets are held by banks as deposits. This lessens the importance of deposits in defining the scope of financial services that banks offer as establishing their market area.[5] In addition, the manner in which assets are held by households has changed considerably, which suggests reinvestment obligations should not only reside with banks but also should encompass the securities industry (see below for more discussion).

FINDING 2: Bank financing of consumer debt stabilized at around 40% of the market

The manner in which household assets are held has changed considerably since CRA was enacted in 1977. Have consumer borrowing patterns and holdings of consumer debt also shifted from CRA-covered banks? When Avery et al.'s publication was released an increasing amount of consumer credit was owned and securitized by finance companies through the 1990's. By 2000, the percent of the consumer loan market held by finance companies was on an upward trajectory, while traditional consumer loans made by CRA-regulated depository institutions were declining (Figure 2). At their peak in 2005, finance companies accounted for 30% of the market, depository institutions still held 53% of consumer debt. The financial crisis and Great Recession changed that, with the amount of consumer loans held by finance companies dropping to 13% by 2021. Meanwhile, the amount of consumer debt owned by the federal government increased from $120 billion in 2008 to $1.4 trillion at the beginning of 2021, or from almost 5% to 34% of the total. Consumers had been considerably over-leveraged, and the extent of this exposure became evident as the effects of the financial crisis unfolded by 2009.[6] Finance companies exited the market, and the federal government substantially increased its holdings in non-revolving consumer debt, such as student loans.[7]

Since that time, the amount of consumer credit owned by depository institutions stabilized to about 40%, which is considerably lower than it was in 1977 at 57%.

5 The Federal Reserve in their Advance Notice of Proposed Rulemaking has suggested that assessment areas not only be areas encompassing bank branches but also areas in which a significant amount of their lending occurs. See https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200921a.htm

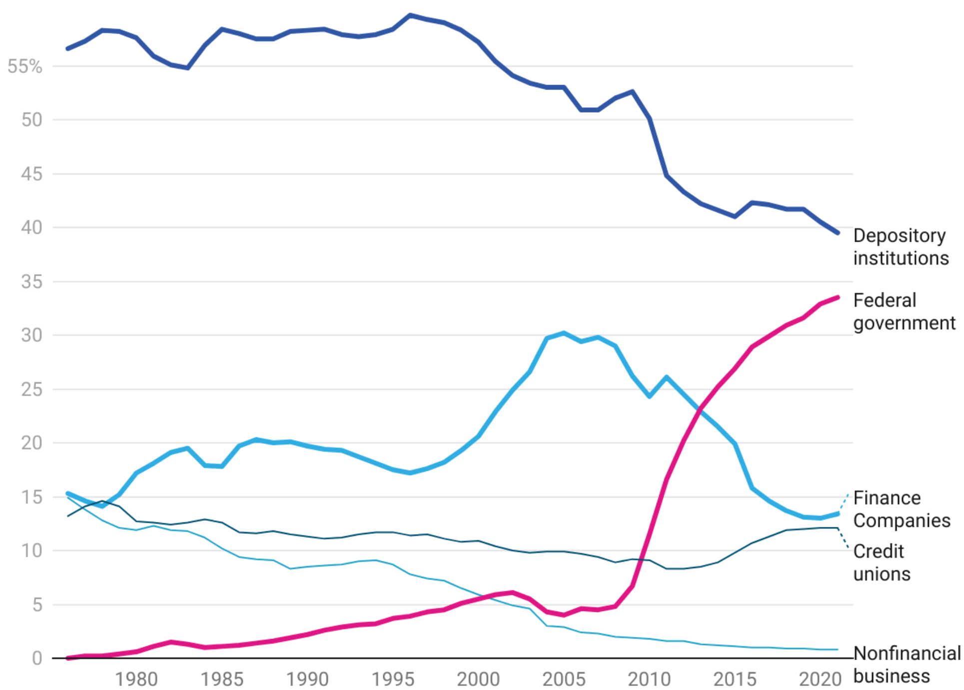
6 William Jarvis and Ian MacMillan, *The Next Crisis,* Harvard Business Review, June 2009, https://hbr.org/2009/06/the-next-crisis https://money.cnn.com/2009/02/06/news/economy/consumer_credit/index.htm

7 Daniel Indiviglio, *The Federal Government's Big Influence on Consumer Credit,* The Atlantic, August 2010, https://www.theatlantic.com/business/archive/2010/08/the-federal-governments-big-influence-on-consumer-credit/61284/

However, the continuing relevance of banks in the consumer lending market, especially in the area of revolving credit such as credit cards, underscores their possible contribution to meeting the financial needs of LMI consumers who often resort to higher-cost alternative financial services.[8]

Ownership of Consumer Debt - Securitized and Unsecuritized

Figure 2: Holdings in securitized and unsecuritized consumer loans by depository institutions, finance companies, credit unions, the federal government and nonfinancial businesses since 1977.



Flow of Funds data not seasonally adjusted

Chart: NCRC • Source: Board of Governors of the Federal Reserve system • Created with Datawrapper

Figure 2: (Source: Board of Governors of the Federal Reserve system, Flow of Funds data not seasonally adjusted: https://www.federalreserve.gov/datadownload/Choose.aspx?rel=g19

8 This Federal Reserve publication shows that lower income households less likely to be "banked,"Federal Reserve System, Report on the Economic Well-Being of U.S. Households in 2019 - May 2020, https://www.federalreserve.gov/publications/2020-economic-well-being-of-us-households-in-2019-banking-and-credit.htm. The FDIC also shows this and table 6.1 on page 37 shows lower income households are more likely to use expensive alternative service providers, Federal Deposit Insurance Corporation, How America Banks: Household Use of Banking and Financial Services, FDIC 2019 survey, https://www.economicinclusion.gov/downloads/2019_FDIC_Unbanked_HH_Survey_Report.pdf

FINDING 3: Decline of banks as the primary mortgage lenders

Directly relevant to CRA is the manner by which home mortgages are originated. In 2007, CRA regulated banks or their affiliates originated 73% of conventional and 59% of government-backed (FHA, VA and USDA) home purchase mortgages (Figures 3a and 3b). This situation has changed rapidly, and by 2012, nonbank mortgage lenders, which have no obligations under CRA, exceeded banks in originations of government-backed loans (54% to 45%). By 2017, the nonbanks also originated more conventional home mortgages (47% to 44%). In 2019, nonbank lenders dominated the market for government-backed loans, originating 78% of those loans while capturing 54% of the conventional market.

A main point of the analysis by Avery et al. was the increased domination of the market by the largest 25 financial institutions. That dynamic shifted after 2007, after which there was a steady increase in mortgage originations by nonbank lenders. The continued support of the secondary market by the now federally-controlled government sponsored enterprises (GSEs or Fannie Mae and Freddie Mac) may have contributed to the increasing market dominance by nonbank lenders. Non-CRA covered mortgage companies' use of government-backed lending such as FHA while large banks retreated from FHA lending also bolstered their position in the market.

However, there is mixed evidence of the impact on the number of mortgage originations to LMI borrowers or neighborhoods, which is a primary objective of CRA. A 2019 study by Urban Institute found evidence that loans in LMI neighborhoods are disproportionately being made to middle- to upper-income borrowers.[9] Yet another study by Calem et al. that same year found an increasing share of LMI borrowers purchasing properties in LMI neighborhoods.[10]

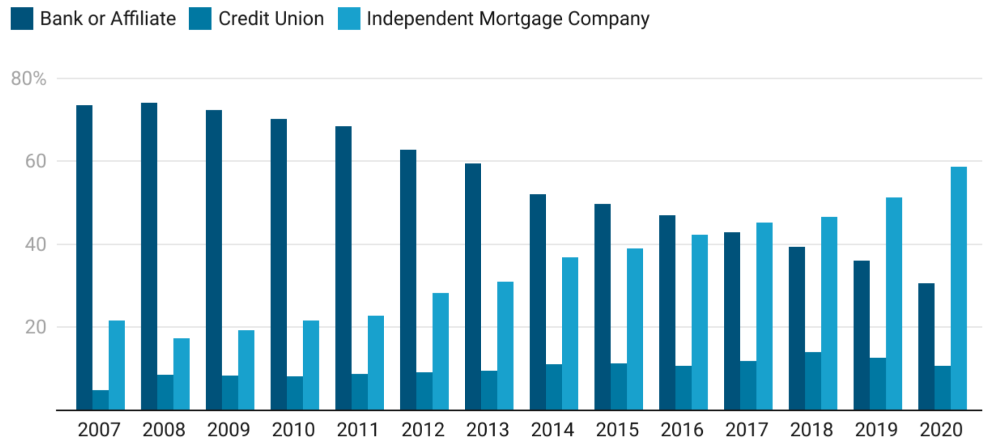
Currently, nonbanks dominate government lending to such an extent that their performance in originating loans for LMI borrowers exceeds that of banks. The ability of the nonbanks to advance opportunities for homeownership for LMI borrowers is a crucial question, since they are not obligated to serve lower income and underserved individuals and communities. While they are out-performing large banks now in LMI markets, it is unclear whether this will continue in the future under different economic conditions and if CRA is not extended to nonbanks.

9 Laurie Goodman and John Walsh, *Most CRA-qualifying loans in low- and moderate-income areas go to middle- and upper-income borrowers,* Urban Institute, March 2019, https://www.urban.org/urban-wire/most-cra-qualifying-loans-low-and-moderate-income-areas-go-middle-and-upper-income-borrowers

10 Paul Calem, Lauren Lambie-Hansen and Susan Wachter, *Is the CRA Still Relevant to Mortgage Lending?* Penn Institute for Urban Research, September 2019, https://penniur.upenn.edu/uploads/media/Calem_Lambie-Hanson_Wachter.pdf

Conventional Mortgage Originations

Figure 3a: Home purchase mortgage originations reported under HMDA by banks, credit unions, and non-bank lenders.

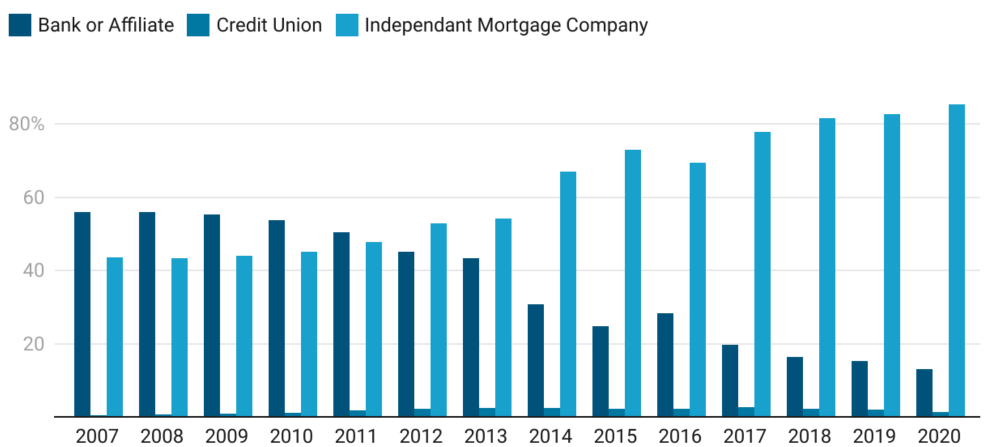


Source: 2007-2019 HMDA home purchase mortgages of 1-4 unit dwellings

Chart: NCRC • Created with Datawrapper

Government-backed Mortgage Originations

Figure 3b: Home purchase mortgage originations reported under HMDA by banks, credit unions, and non-bank lenders.



Source: 2007-2019 HMDA home purchase mortgages of 1-4 unit dwellings

Chart: NCRC • Created with Datawrapper

Figures 3a & 3b: (Source: 2007-2019 HMDA home purchase mortgages of 1-4 unit dwellings https://public.tableau.com/app/profile/ncrc.research/viz/BankVersusNon-BankMarketShare/BankVersusNon-BankMarketShare_1)

FINDING 4: Under conservatorship, the GSEs hold a majority of mortgage debt, while the portion held by banks continues to decline

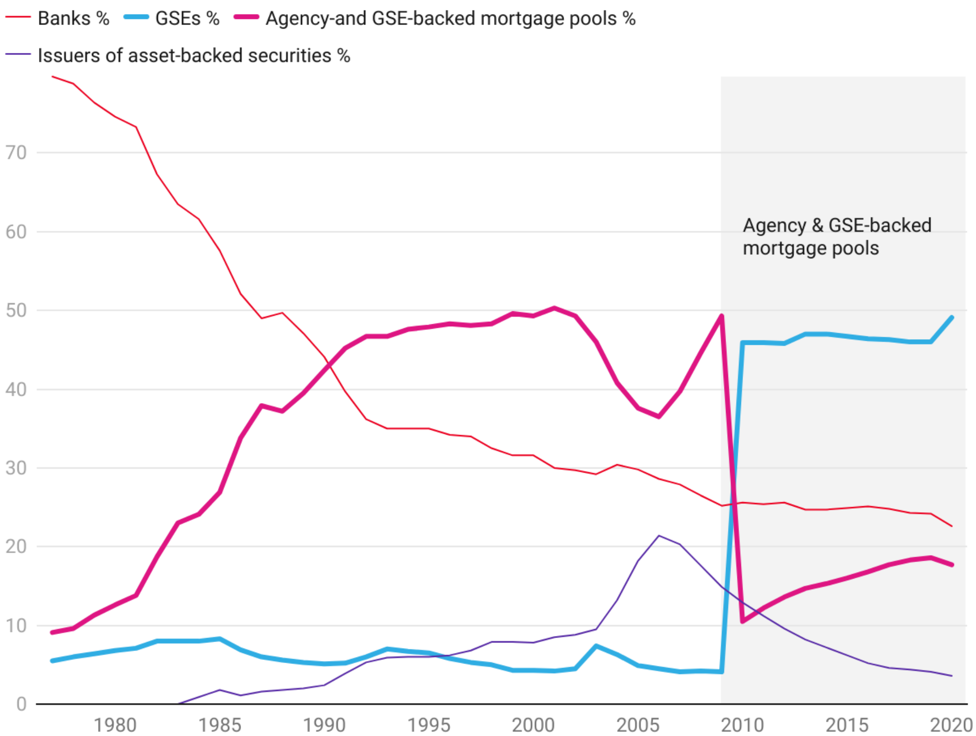
Mortgage lending is an area of the financial services market in which there have been profound changes since CRA was implemented. In 1977, 73.8% of home mortgages were originated and held by banks (Figure 4). There was a considerable shift in the 1980's and

1990's with the securitization of mortgage debt and the growth of a secondary mortgage market to facilitate this. Securitized mortgage debt held by the GSEs in agency-backed pools exceeded the mortgage debt holdings of banks in 1991. By 2007, banks held only 28% of mortgages, while mortgage pools comprised 58% of the holdings.

In order to prevent economic collapse during the financial crisis, the GSE's were placed under federal conservatorship in September 2008. The conservatorship has continued since that time, and the largest holders of residential mortgages in 2020 are the federally controlled GSE's (47.9%), depository institutions (22.1%), agency and GSE-backed pools (17.2%), and issuers of asset-backed securities (3.6%).[11] While not directly related to CRA, the GSEs are obligated to facilitate the secondary market through their affordable housing goals and "duty to serve" requirements to LMI families.

Holdings of US Mortgage Debt

Figure 4: Outstanding home mortgage debt held by depository institutions, GSEs, and as asset-backed securities.



Does not show mortgage holdings by credit unions, foreign banks, finance companies, private or state and local government pension funds, or REITs; all of which total less than 10% of mortgage debt holdings

Chart: NCRC • Source: Board of Governors of the Federal Reserve system, Flow of Funds data • Created with Datawrapper

Figure 4: (Source: Board of Governors of the Federal Reserve system, Flow of Funds data: https://www.federalreserve.gov/releases/z1/default.htm. Does not show mortgage holdings by credit unions, foreign banks, finance companies, private or state and local government pension funds or REITs; all of which total less than 10% of mortgage debt holdings)[12]

11 For additional information on secondary market activity, see Urban Institute, *Housing Finance at A Glance: A Monthly Chartbook,* July 2021, pp. 6-7, https://www.urban.org/sites/default/files/publication/104602/july-chartbook-2021_2.pdf

12 As a result of two new accounting rules, FAS 166 and 167, the assets and liabilities of some special purpose entities (SPEs) have been moved onto the balance sheets of the government-sponsored enterprise sector (table L.124). The consolidated assets and liabilities were removed from the agency and GSE-backed mortgage pool sector (L.125) and the issuers of asset-backed securities (ABS) sector (table L.126). Almost all of the consolidations resulting from the new accounting rules occurred in the first quarter of 2010. In the Flow of Funds Accounts, these changes are treated as discontinuities that affect the levels of outstanding assets and liabilities in the relevant sectors, but not the flows. See 2010 q1. https://www.google.com/url?q=https://www.federalreserve.gov/apps/fof/FOFHighlight.aspx&sa=D&source=editors&ust=1632505346671000&usg=AOvVaw0c96P5LaW1Hdsdni5Bgs-W

Making CRA relevant for a changing financial services industry

The discussion above had four major findings:

1. The securities industry has a large share of household assets.
2. Banks remain a major source of consumer loans.
3. CRA noncovered mortgage companies now make most of the mortgage loans.
4. GSEs hold a large share of outstanding mortgage debt.

Policy implications of Finding 1: More household savings held by the securities industry suggests a reinvestment obligation for that industry.

The first finding, that the securities industry has captured a large share of household assets while the share of household assets held by banks in the form of deposits has declined, suggests that if CRA remains confined to banks, the ability of CRA to ensure that the financial industry is serving all communities will decrease. Stated another way, if the securities industry is holding a greater and significant share of household wealth, shouldn't they also have an affirmative obligation to serve all communities?

In addition to holding a greater share of household wealth, the securities industry relies on government support to operate like banks. Government support is one of the rationales for CRA: since the people via their government provide critical support to financial institutions, the financial institutions should have an obligation to reinvest in communities. Securities firms have a backstop that is similar to Federal Deposit Insurance for banks. The Securities Investor Protection Corporation (SIPC) protects investors up to $500,000 in the event of the bankruptcy of a securities firm.[13] Since 1970, SIPC has recovered more than $141 billion in assets for about 773,000 investors.[14] Since the securities industry relies on federal protection, a reinvestment obligation is a fair quid pro quo.

The securities industry has companies that operate as retailers and wholesalers (who do not interact regularly with retail customers). Retail brokerage firms sell various funds to retail customers while wholesalers, asset managers and investment banks, create and/or manage investment funds. CRA evaluations for retailers would examine the performance of a securities company based on the number and percent of accounts for LMI and people of color. Comparisons would be made to peer companies and the demographics of areas served by the securities firms.

CRA exams for wholesalers would focus on a community development (CD) test that would ensure that investments were benefiting LMI and people of color and their communities. Securities companies could further develop funds that would invest in small businesses that

13 Securities Investor Protection Corporation (SIPC), SIPC Mission, https://www.sipc.org/about-sipc/sipc-mission

14 SIPC, History and Track Record, https://www.sipc.org/about-sipc/history

are located in LMI communities and communities of color. The CD test would scrutinize the level of investments in these funds and their innovation and responsiveness to community needs. Some companies are hybrid in that they are both retailers and wholesalers; for these, a CRA exam can include a retail and a CD test.

In past Congressional sessions, CRA modernization legislation has been introduced to apply CRA to the securities industry. Sponsored by Rep. Eddie Bernice Johnson (D-TX) during the 111th Congress in 2009-2010, H.R. 1479, the Community Reinvestment Modernization Act of 2009, required the Securities and Exchange Commission (SEC) to evaluate and rate securities companies.[15] As appropriate, the exams would contain a retail test scrutinizing the proportion of customers that are LMI and a community development investment test looking at the number and dollar amount of community development investments benefiting LMI and underserved communities.

Another bill in the 111th Congress, The American Community Investment Reform Act of 2010 or H.R. 6334, focussed on requiring the securities industry to engage in community development financing.[16] The SEC would evaluate and rate securities companies on their record of community development financing. These investments would be targeted to affordable housing and economic and community development of LMI communities.

Policy implication of Finding 2: CRA bank evaluations must be more common and rigorous for consumer lending. Policymakers should contemplate expanding CRA to fintech consumer lenders but not payday and other fringe lenders.

The second finding was that the bank share of outstanding consumer loans declined and then rebounded over the time period examined. The share held by nondepository institutions declined, however, it is possible this share will grow again due to the dramatic increases in consumer lending by nondepository and non-CRA covered financial technology companies.

This finding has two major implications. One is that CRA exam consideration of consumer lending should be made more rigorous and the second is that CRA should be expanded to certain types of nondepository financial technology institutions. A strong case can be made that CRA exams should scrutinize bank consumer lending to ensure that such lending is an affordable and sustainable alternative to the high cost and often abusive lending of payday lenders and other fringe providers.

A second implication is more research and thought is needed to consider whether CRA should be extended to nonbanks that engage in consumer lending. It is beyond the scope of

15 H.R.1479 - Community Reinvestment Modernization Act of 2009, Sec. 107. Responsiveness to community needs for securities and investment services, https://www.congress.gov/bill/111th-congress/house-bill/1479/text?r=32&s=1

16 H.R.6334 - American Community Investment Reform Act of 2010, https://www.congress.gov/bill/111th-congress/house-bill/6334?q=%7B%22search%22%3A%5B%22%5C%22community+reinvestment+act%5C%22%22%5D%7D&s=6&r=66

this paper to examine the state of payday lending, but widespread abuses have occured in payday lending. These lenders do not have federal government support or are regulated at a federal level regarding consumer protection or fair lending, which would be preconditions before CRA is applied to them at a federal level. In contrast, whether CRA should be extended to the newer financial technology companies that are more akin to credit card lenders and banks that make term loans should be considered by policymakers. If CRA were applied to them, the financial technology companies would also need to be examined at the federal level for consumer protection and fair lending compliance.

Banks undergo CRA evaluations of their consumer lending when such lending is the great majority of their business or at the option of the bank.[17] CRA evaluations that include consumer lending are not frequent (the Government Accountability Office found in their sample of banks that just 25% of large banks and 3% of intermediate small bank CRA exams contained evaluations of consumer lending).[18] Moreover, large credit card companies have been designated as wholesale and limited purpose banks that have a community development financing test but not a retail test.[19] This designation should be re-evaluated. It is important that CRA ensures that large credit card lenders are not only serving retail LMI customers but doing so responsibly with products that are affordable alternatives to those offered by payday lenders and other fringe lenders.

Consumers and households, particularly those with limited incomes, can have sudden, unexpected and dire needs for consumer loans. This can occur when their cars, their primary mode of transportation in communities lacking mass transit, break down or when they experience medical emergencies that are not fully covered by their medical insurance. CRA could have an important role ensuring that these credit needs are met responsibly.

Policy implications of finding 3 - CRA should be expanded to non-CRA covered independent mortgage companies and CRA exams for large banks should be more rigorous.

The third finding was that mortgage company share of home lending has increased significantly and has overtaken that of banks. Moreover, in recent years, mortgage companies have performed better than banks, particularly larger banks, in terms of the percentage

17 FDIC CRA regulations, § 345.22 Lending test, Scope of Test, https://www.fdic.gov/regulations/laws/rules/2000-6500.html#fdic2000part345.22

18 Government Accountability Office, *Community Reinvestment Act: Options for Treasury to Consider to Encourage Services and Small-Dollar Loans When Reviewing* Framework, February 2018, p. 31, https://www.gao.gov/products/gao-18-244

19 See the FDIC CRA regulations, § 345.25 Community development test for wholesale or limited purpose banks. To see examples of credit card banks designated as wholesale and limited purpose banks, see FFIEC interagency CRA ratings page, https://www.ffiec.gov/craratings/default.aspx

of loans offered to LMI borrowers and communities.[20] Despite this turn of events, NCRC continues to call for CRA to be extended to mortgage companies.

There is no way to determine if the recent performance of mortgage companies will continue or revert back to earlier years when NCRC found that the average bank was performing better than the typical mortgage company at lending to LMI communities.[21] Also, within the mortgage industry, performance will be uneven with some companies serving LMI populations well while others need to be pushed to do a better job. Finally, mortgage companies rely on the federal government in that they are heavy users of government guaranteed lending and large-scale sellers of their loans to Fannie Mae and Freddie Mac. The quid pro quo is that CRA should ensure that they are serving LMI and other underserved populations fairly and responsibly.

Another reason to apply CRA to mortgage companies is to ensure that their lending is responsible. Prior to the financial crisis, independent mortgage companies made a substantially higher share of high cost loans that resulted in foreclosure than banks.[22] Banks made more affordable and sustainable loans than mortgage companies because CRA only applied to banks and required them to lend in a safe and sound manner. The high cost lending by mortgage companies compelled community-based organizations in Massachusetts to successfully advocate for the state's CRA law to apply to mortgage companies.[23]

In 2007, Massachusetts applied their CRA law to mortgage companies. An NCRC paper found that the Massachusetts CRA law and regulation is objective and not unduly burdensome for mortgage companies.[24] The great majority pass their exams and the exams effectively differentiate performance, awarding higher ratings to those companies that offer higher percentages of home loans to LMI borrowers and communities and offer higher levels of community development services such as housing counseling or grants to community-based organizations that offer counselling. An objective CRA regime that awards higher ratings to better performers is likely over the long term to stimulate more lending and services to underserved communities by motivating the laggards to improve their performance.

20 Jason Richardson, Joshua Devine, Jad Edlebi, *2020 HMDA Preliminary Analysis*, NCRC, August 2021, https://www.ncrc.org/2020-hmda-preliminary-analysis/. Also, see Calem, Lambie-Hanson and Wachter cited above regarding comparisons of large banks, small banks and mortgage companies.

21 Jason Richardson and Josh Silver, *Home Lending To LMI Borrowers And Communities By Banks Compared To Non-Banks,* NCRC, April 2019, https://www.ncrc.org/home-lending-to-lmi-borrowers-and-communities-by-banks-compared-to-non-banks/

22 Elizabeth Laderman and Carolina Reid, *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, p. 122 https://www.frbsf.org/community-development/files/cra_lending_during_subprime_meltdown.pdf

23 Elizabeth Gehrman, *Home is Where the Heart Is,* Boston Globe, October 2008, https://mahahome.org/sites/MAHA-PR1/files/Globe%20Magazine%20small%20frame-legal.pdf

24 Josh Silver, *Massachusetts CRA For Mortgage Companies: A Good Starting Point For Federal Policy*, NCRC, July 2021, https://ncrc.org/massachusetts-cra-for-mortgage-companies-a-good-starting-point-for-federal-policy/

The third finding also suggests that CRA exams for banks should be more rigorous in order to improve bank performance relative to independent mortgage companies. In particular, exams for larger banks should be bolstered in terms of holding them to a higher standard, since they have been outperformed by smaller banks and mortgage companies. The Federal Reserve Board, in their Advance Notice of Proposed Rulemaking (ANPR) issued last year, offered a number of suggestions for improving the CRA lending test. Ratings would be more objective based on how well banks perform against industry and demographic benchmarks. While these metrics need additional refinement, including the Federal Reserve evaluating how they would impact the distribution of CRA ratings, the proposals are a good starting point for making exams more robust and increasing agency expectations for serving CRA's target populations in a fair and responsible manner.[25]

For both banks and mortgage companies, CRA exams should also include evaluations of lending and service to people and communities of color. This would be consistent with the intention of Senator William Proxmire and the other Congressional authors of CRA who focused on redlining in communities of color.[26] NCRC recently authored a paper explaining how race can be explicitly added to CRA exams in a manner that can pass constitutional muster.[27]

Sen. Elizabeth Warren and Rep. Emanuel Cleaver introduced the American Housing and Economic Recovery Act of 2021, Section 203 of which would apply CRA to independent mortgage companies in a manner similar to Massachusetts' CRA law.[28] In addition, the bill would improve CRA exams for banks by adding additional ratings and including additional scrutiny of how banks are meeting the needs in underserved urban and rural areas.

25 NCRC Comment On Federal Reserve Board's Advance Notice Of Proposed Rulemaking Regarding The Community Reinvestment Act – February 2021, https://ncrc.org/ncrc-comment-on-federal-reserve-boards-advance-notice-of-proposed-rulemaking-regarding-the-community-reinvestment-act-february-2021/

26 Josh Silver, *The purpose and design of the Community Reinvestment Act (CRA): An examination of the 1977 hearings and passage of the CRA,* NCRC, June 2019, https://ncrc.org/the-purpose-and-design-of-the-community-reinvestment-act-cra-an-examination-of-the-1977-hearings-and-passage-of-the-cra/

27 Brad Blower, General Counsel, NCRC; Josh Silver, Senior Policy Advisory, NCRC; Jason Richardson, Director of Research and Evaluation, NCRC; Glenn Schlactus, Partner, Relman Colfax PLLC; Sacha Markano-Stark, Attorney, Relman Colfax PLLC, *Adding Robust Consideration Of Race To Community Reinvestment Act Regulations: An Essential And Constitutional Proposal,* NCRC, September 2021, https://www.ncrc.org/adding-robust-consideration-of-race-to-community-reinvestment-act-regulations-an-essential-and-constitutional-proposal/

28 For text of the American Housing and Economic Recovery Act, Section 203, see https://www.congress.gov/bill/117th-congress/senate-bill/1368/text?q=%7B%22search%22%3A%5B%22American+Housing+and+Economic+Recovery+Act+Elizabeth+Warren%22%5D%7D&r=4&s=4#toc-idD7EC3B4975B74D01A2A28F4E7FAEAFD0

Policy implications of Finding 4: GSE have a large share of outstanding debt, suggesting that their duty to serve or CRA-like obligations must be robust and not just at the national level.

The GSEs had lost market share of outstanding mortgage debt before the financial crisis but have rebuilt their share since. The GSEs have two obligations akin to CRA: the affordable housing goals and the duty to serve requirements. It is beyond the scope of this discussion to provide details on these two requirements but suffice it to say that affordable housing goals are set on a national level and consist of goals expressed in terms of percentages of loans made to LMI borrowers, LMI communities and communities of color.[29] The duty to serve requirements focus on distinct underserved markets including rural communities and manufactured housing.[30]

The shortcoming in both of these is that the goals are expressed on a national level whereas CRA evaluates bank performance on a state, metropolitan and rural level. Since community needs, economic conditions and demographics vary on a local level, any CRA or duty to serve obligation should also consider performance on a local level. Both the affordable housing goals and duty to serve requirements could evaluate GSE performance across states, metropolitan areas and rural counties. The Federal Housing Finance Agency (FHFA), the regulator of the GSEs, could then encourage the GSEs to improve performance in the geographical areas where they lag both their average performance and that of the primary market (banks, mortgage companies and credit unions). This would improve the geographic focus of the duty to serve requirements and the affordable housing goals, better meeting the needs of areas where there is greater economic distress.

On their part, CRA exams assess the secondary market performance of banks, that is their purchases of loans made by other banks or nonbanks. Since banks still hold a significant amount of mortgage debt, this aspect of CRA exams is important but must be conducted with more nuance than currently. Purchasing activity is generally not as difficult as originating loans. NCRC has therefore urged the federal bank agencies to weigh purchases less than loan originations; this recommendation will hopefully be addressed in the upcoming CRA regulatory reform. In addition, purchasing loans from smaller banks, Community Development Financial Institutions (CDFIs) and Minority Depository Institutions (MDIs) is more important than making purchases from larger institutions because these smaller institutions often lack the capital with which they can make more loans. Accordingly, loan purchases from the smaller lenders should receive more weight on the quantitative or qualitative portion of the lending test than purchases from larger institutions.

29 For more information about the Affordable Housing Goals, see the recent proposed rulemaking concerning the goals via https://www.fhfa.gov/SupervisionRegulation/Rules/Pages/2022-2024-Enterprise-Housing-Goals-Proposed-Rule.aspx

30 For more information about the Duty-to-Serve requirements, see https://www.fhfa.gov/PolicyProgramsResearch/Programs/Pages/Duty-to-Serve.aspx?utm_medium=email&utm_source=govdelivery

Conclusion

Former Comptroller of the Currency Eugene Ludwig stated the case succinctly for expanding CRA broadly. His findings mirrored ours - nonbanks have attained a significant market share of various financial products and they benefit from government support. He stated that:

> So what do these fundamental changes mean for the low- and moderate-income neighborhoods and why does it make sense to expand the CRA? First, the obligation to meet the needs of low- and moderate-income neighborhoods is not being applied to nonbank financial services companies, whose share of financial assets now exceed those of banks and thrifts, and whose holdings continue to grow. Absent a CRA mandate that all financial services companies meet the needs of low- and moderate-income neighborhoods in the areas they serve, and an expansion of the CRA mandate to non-credit-related services, these lower-income areas will continue to be underserved in financial services and fall prey to unscrupulous practices. Low- and moderate-income areas need access to other financial services and products–from insurance, savings,....and securities services–on fair, nonpredatory terms. This is even more urgent as financial services continue their shift from traditional banks to a more complex set of institutions and products. Second, banks and thrifts are no longer the only financial service providers that benefit from the federal safety net, as they were in 1977.[31]

Similar to Ludwig, this paper found that security company holdings of household wealth (savings) exceeded that of banks and that non-CRA covered mortgage companies have issued more loans than banks in recent years. The situation in consumer lending markets is different with banks still the largest player but the rise of fintech consumer lenders may alter that marketplace in future years.

If CRA obligations are not extended beyond banks, the ability of financial sector law to leverage reinvestment will decline due to the rise of the nonbanks and their significant share of the market. In addition, it is imperative to expand duty to serve obligations to nonbanks, even those that appear to be out-performing banks in LMI markets. It is unclear whether that dynamic will continue, but what is clear is that LMI communities will remain underserved and vulnerable to predatory lenders if reinvestment obligations that require safe and sound products are not broadly applied to the financial industry as Ludwig asserted.

Ludwig also addressed the insurance industry, which this paper did not study due mainly to a lack of national level data on that industry. However, there are similarities between the insurance industry and the industries discussed in terms of government support and a history of redlining. A good place to start with the insurance industry is data disclosure requirements

31 Eugene A. Ludwig,James Kamihachi and Laura Toh, *The Community Reinvestment Act: Past Successes and Future Opportunities,* in Revisiting the CRA: Perspectives on the Futrue of the Community Reinvestment Act, Federal Reserve Banks of Boston and San Francisco, February 2009, https://www.frbsf.org/community-development/files/cra_past_successes_future_opportunities.pdf, p. 100

so that patterns of service or lack thereof in LMI and communities of color can be assessed. Precedents exist including voluntary data disclosure similar to Home Mortgage Disclosure Act data for private mortgage insurance companies and disclosure of community development financing required by the state of California for insurance companies.[32]

Congress made modest improvements to CRA in the 1994 Riegle-Neal Act but missed opportunities in the Gramm-Leach-Bliley Act of 1999 and more recently in the Dodd-Frank Act of 2010. However, there are previous and current bills that have been introduced that Congress can borrow from and include in future legislation, hopefully soon. In addition, the federal bank agencies have an opportunity now to make CRA more robust along the lines discussed.

A failure by Congress and the regulatory agencies to broaden CRA's reach and to make it more robust will only in the long term exacerbate inequalities, including racial disparities that ultimately drag on overall economic growth and wellbeing.

32 For a discussion about CRA-like or data disclosure requirements for the insurance industry, see Josh Silver, *Expanding CRA to Non-Bank Lenders and Insurance Companies,* NCRC, August 2020, https://www.ncrc.org/expanding-cra-to-non-bank-lenders-and-insurance-companies/