A New Look at the CRA

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The Community Reinvestment Act (CRA) of 1977 has been a part of the bank regulatory environment for over 30 years. While the statute itself and the regulations that implement it have changed over the intervening decades, a re-examination of the CRA seems particularly relevant in the current environment:

- The banking and broader financial services industries have changed significantly since the CRA was passed, and indeed, have changed significantly since the last major overhaul of the regulations in 1995. The intervening years have been marked by new institutions, new products, and a significantly changed regulatory framework.
- The turmoil in the mortgage, credit, and financial markets has prompted calls for a broad re-examination of how the universe of financial market participants is regulated and supervised.
- The crisis in subprime mortgage lending has prompted questions about the supervisory conditions under which subprime lending can be done responsibly.

These developments have raised questions about what role the CRA should play in financial services regulation, and to whom the CRA ought to apply. In response to the call for a re-examination of the CRA, the Federal Reserve Banks of Boston and San Francisco are jointly preparing a publication that captures the views of some of the leading thinkers on the future of the CRA. The contributors, who include bankers, community-based organizations, and academics, offer a broad range of observations and proposals.

While the publication will be available under separate cover in February, 2009, the authors of this article have identified a set of themes and key questions that emerge from these analyses and commentaries. These themes and questions are not policy proposals, or descriptions of a particular solution. Rather, they are an extended range of questions for policymakers and market participants to grapple with as they consider the future of the CRA.

What IS the CRA?

One key set of questions that arises in this re-examination of the CRA is related to the philosophical underpinnings or justifications for the CRA. What is the underlying intent of the CRA? Is it intended to repair a market failure, perhaps a lack of information about credit quality in low-income areas? Is it intended to encourage banks to look harder for business opportunities that they otherwise would have missed? Is it intended to compel, or encourage, banks to help meet social policy objectives, perhaps as compensation for the privilege of the bank charter or deposit insurance? If the latter, is the intent of the CRA to encourage banks to do things that are somewhat less profitable to further the social goal? To do things that are unprofitable? Have the philosophical underpinnings of the CRA evolved over time as the regulations and the banking environment have changed?

These questions emerge from the current arrangement, in which the CRA applies only to banks and thrifts. If the CRA were to be expanded to other sorts of financial institutions, what justifications or philosophical underpinnings might apply? If we consider taxpayer subsidy or support to be the "hook" on which we hang the CRA for the banks and thrifts, recent events suggest that other industries that enjoy explicit or implicit taxpayer support would be subject to the same analysis. While the Congress found in the CRA that banks have a "continuing and affirmative obligation" to help meet the credit needs of the communities in which they are chartered, do other types of financial institutions have the same obligation?

People versus Place

Another of the key themes raised by a re-examination of the CRA is the question of whether the CRA ought to be targeted at people or geographies. The current regulations measure how well financial institutions are serving the credit needs of both low- and moderate-income geographies and low- and moderate-income people in their assessment areas.

Several questions emerge from this arrangement. The notion of a financial institution's "assessment area" based on branch locations merits review, particularly with the evolution of financial services delivery mechanisms that do not rely on a branch network. If the assessment area is not based on branch presence, how should it be defined? If an institution makes loans in a geography, or passes some threshold for market share in a geography, should that geography be included in the bank's assessment area?

The questions raised under this theme are different for other types of financial institutions. For financial institutions without a consumer product delivery presence, a CRA-like requirement might examine these institutions' role in supporting community development finance, but a clear regulation would need to define where this support would be required to be provided, to whom, and in what form.

Another question is whether the population segments targeted by the CRA should be based solely on income, or if race should be introduced into the CRA calculus. If a guiding principle of the CRA is that financial institutions should serve the credit needs of "the entire community," policymakers might contemplate procedures that take race into consideration when determining which segments of the population are underserved.

Incentives for CRA Performance

Recent trends in CRA ratings show that the vast majority of institutions have a Satisfactory or Outstanding CRA rating. The rewards of having an Outstanding CRA rating can be difficult to quantify, and many institutions seem perfectly happy with a Satisfactory rating. Should a new CRA rule consider some reward for "stretching," for example by rewarding Outstanding institutions with favorable treatment? Or should the CRA just be a floor, ensuring that institutions are doing a reasonably good job of meeting credit needs?

Disclosure of CRA Performance

One critical aspect of the CRA's impact on the industry and the communities it serves is the public nature of the CRA performance evaluation. Any member of the public can access an evaluation and form his/her own opinion about the institution's performance, and interact with the bank to encourage greater community development activity.

In light of the ease with which the public can access this information, what role does disclosure play? Should the law simply require disclosure of information about products and services, terms, geographies served, etc., or should it encourage institutions to adopt new products or practices? How can community organizations play a role in using the information to encourage change?

And Finally… Do We Still Need the CRA?

The question of whether the CRA is needed in the first place is also directly related to the question of the philosophical underpinnings of the CRA. Has the problem that prompted the creation of the CRA, specifically, the practice of redlining, been solved? Is it useful in achieving other social goods, such as poverty alleviation, affordable housing, or neighborhood revitalization?

While we can frame this discussion using the CRA as a starting point, policy makers may also want to think in terms of a blank slate. What 21st century market issues exist? What inequalities are of concern? Can the CRA solve these issues, and if so, does the law need to be expanded or revised? Or, if the CRA is specific to the banks, then should the response to these broader issues be grounded in something other than the CRA?

A Framework for Discussion

Our hope for the forthcoming publication is that it will offer a framework for discussion. A review of the CRA raises many questions, some of which have been explored here in a preliminary way. A more thorough treatment of these questions, as well as others that emerge, will lay the groundwork for a thoughtful examination of the CRA and its role in the regulation of financial services. We invite all concerned parties to contribute to the discussion.

CRA and the Subprime Crisis

Box 7.1

The CRA has recently come under attack from a number of critics in light of the subprime mortgage crisis. They argue that the law caused banking institutions to engage in high-risk mortgage lending in order to fulfill their CRA obligations to help meet the credit needs of low-income borrowers and areas. However, no empirical evidence has been presented to support these claims. Ben Bernanke, Chairman of the Federal Reserve System, recently stated, "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 any substantive way to, the current mortgage difficulties."[1] A growing body of empirical research refutes the charges against the CRA:

- Over the thirty year track record of the CRA, lending to lower-income individuals and communities has been nearly as profitable and performed similarly to other types of lending done by CRA-covered institutions. The long-term evidence shows that the CRA has not pushed banks into extending loans that perform out of line with their traditional businesses.[2]
- During the height of the subprime boom, only 6 percent of all the higher-priced loans were extended by CRA-covered lenders to lower-income borrowers or neighborhoods in their CRA assessment areas. The very small share of all higher-priced loan originations that can reasonably be attributed to the CRA is contrary to the charge that the law contributed significantly to the current subprime crisis.[3]
- Financial institutions seeking CRA credit can also purchase loans from lenders not covered by the CRA. However, less than 2 percent of the higher-priced and CRA-credit-eligible mortgage originations sold by independent mortgage companies were purchased by CRA-covered institutions.
- A recent study based on loans originated in California between January 2004 and December 2006 found that loans originated by lenders regulated under the CRA, in general, were significantly less likely to be in foreclosure than those originated by independent mortgage companies. Further, loans made by CRA lenders within their assessment areas were generally half as likely to go into foreclosure as those made by independent mortgage companies not covered by the CRA.[4]

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3. Subtracting out the $6.5 billion currently provided to three- and four-year olds through Head Start yields the $18 billion figure for new costs. The long-term goal would be to bring the national Head Start program and the burgeoning state pre-kindergarten programs together into an expanded national pre-kindergarten initiative that provides comprehensive, high-quality services to three- and four-year-olds. Initially, however, the federal government might have to continue separate funding streams for Head Start and the new pre-kindergarten initiative.
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