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STATEMENT OF
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BEFORE THE
FEDERAL RESERVE BANK OF CHICAGO
COMMUNITY REINVESTMENT ACT (CRA) HEARING

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I want to thank the Federal Reserve of Chicago for hosting this hearing to discuss the Community Reinvestment Act (CRA). And I commend all our federal bank regulators for their leadership in undertaking this endeavor to consider enhancements that will advance the cause of equitable credit availability, promote sound lending practices, and otherwise ensure the availability of banking services to underserved communities.

More than thirty-three years have passed since the CRA became law, and in that time it has done great and measurable good. At the same time, since its passage, and particularly in the past three years, we have witnessed extraordinary changes in finance. The task today is a worthy one—to examine how the CRA can contribute most effectively to shaping a stronger, but equitable, financial system.

Although the CRA has been the law for decades, it has always attracted its fair share of debate. Bankers have sometimes criticized the CRA as unnecessary and burdensome, particularly to small banks. That criticism was more prevalent before the Clinton Administration's 1994 regulatory reforms of the CRA, which—as the 27th Comptroller of the Currency—it was my privilege to lead. Our efforts resulted in banks committing more new money to CRA lending than they had committed previously over the entire period since the passage of the Act in 1977. We accomplished this by eliminating unnecessary burdens on banks and by assessing actual performance. I might add that the credit made available to low- and moderate-income Americans through CRA programs during this era – the 1990s – was not only transforming for low- and moderate-income (LMI) communities, but it was almost without exception profitable and safe.

Unfortunately, the CRA is not keeping up with innovations and trends in the financial industry, most notably industry consolidation and non-depository lending, and this is eroding the Act's effectiveness. The financial services business and the manner in which financial products are structured, offered, delivered, and held by institutions and investors has fundamentally changed since 1977. At the time Congress was debating the CRA, banks were the dominant financial services companies and were the dominant debt holders. Banking was still largely a local matter—trillion dollar, coast to coast banking operations were on the distant horizon and not the reality. Over the last thirty-five years, however, the banking and thrift industries have been losing ground to other financial companies, as has community banking. The result is that non-bank lenders now hold more credit-market assets than do banks and thrifts, and the largest banking organizations in America dwarf the community banking sector.

Vigorous application of the CRA is as necessary now as it was in 1977, in order to ensure that there continues to be a flow of investment on fair terms to LMI neighborhoods. Reining in the excesses of subprime lending may have a disproportionate impact on LMI areas, especially if lenders and investors take away the wrong lesson from the experience – that LMI borrowers are not good credit risks. Indeed, inner cities and economically declining regions require large capital investment in infrastructure and the demolition or rehabilitation of dilapidated properties, if they are to be attractive environments for private capital investment.

How, then, do we reconcile providing credit to the under-served while at the same time protecting consumers and the economy? I recommend the following:

1. Apply the obligation to meet the needs of LMI neighborhoods and communities to non-bank financial services companies. Their share of financial assets now exceeds those of banks and thrifts, and their holdings continue to grow. The Federal Reserve is in essence open to supporting almost all large financial services companies, regardless of charter. Broker-dealers, insurance companies, and credit unions should be covered by the CRA, at a minimum. Ideally, the CRA would also apply to all other major financial institutions important to the maintenance of a stable economy, such as hedge funds and private equity funds with more than $250 million in assets, consistent with the Gramm-Leach-Bliley Act's small bank size cutoff.

2. The holding company structure allows banks to reduce their CRA obligations by pushing activities out of the bank onto holding company affiliates; this has been going on for a while and is common in the mortgage and consumer lending areas. This anomaly needs to be rectified.

3. In many cases, the area served by a bank is no longer self-evident or defined by a geographic community. Virtually all of the top fifty banking companies have extensive interstate

banking operations. Anchoring CRA obligations to the LMI area surrounding a charter or headquarters location does not reflect the reality of their businesses or their impact on LMI consumers. We need to assess whether institutions that conduct business in multiple states are reasonably distributing their CRA lending among the communities they serve. In some cases of national providers, a broad national approach to CRA is warranted.

4. In the current state of the economy, we should strongly encourage institutions to make loans that create permanent jobs in LMI census tracts. Lenders should receive CRA credit for loans to businesses that generate new jobs in LMI areas and additional credit, if the loan is to an LMI borrower.
5. We should consider granting CRA credit to lenders that establish effective loan programs for converting existing predatory loans to homeowners living in LMI census tracts into conventional loans.
6. An expansion of the concept of CRA more squarely to include financial services broadly, not just credit, would help LMI individuals and geographies greatly. For example, where appropriate an emphasis on making savings products more broadly available would add value. In this regard, a CRA emphasis on some level of equity investment and innovation would also help LMI geographies and our economy more generally.

Finally, we need to alter our national conversation about credit, placing a renewed emphasis on jobs and small businesses rather than homes. And we should study and learn from the successful practices that micro-credit and other experts have had around the world.

Conclusion

In conclusion the CRA is not a panacea, but the CRA has proven it can help, and help materially, with the financial needs of individuals and communities. In the wake of the economic crisis, these needs are as acute as ever.

The CRA needs to be modernized, but moving it into the 21st century requires the same kind of care and creativity that fostered the Act in 1977, and provided for its reform in the 1990s. The heart of the problem that the CRA was intended to solve remains – that is, the need for the financial services sector to deliver enough support to local communities. I am confident that a modernized CRA can and should be a part of the solution for a stronger and fairer financial services system for our country in the years to come.