The Future of the Community Reinvestment Act

Testimony of Mark Pinsky
President and CEO, Opportunity Finance Network

Interagency Public Hearing
Chicago, IL

August 12, 2010

Good morning. I am Mark Pinsky, President and CEO of the Opportunity Finance Network (OFN). OFN, the national network of more than 170 financial institutions, creates growth that is good for communities, investors, individuals, and the economy. Its members include CDFIs and other opportunity finance institutions that work just outside the margins of conventional finance to bring those markets into the economic mainstream and to help the economic mainstream flow into those markets. CDFI financing has resulted in significant numbers of new jobs, jobs preserved, quality, affordable housing units, and new commercial and community facility space in all 50 states. Over the past 30 years, the Opportunity Finance industry has provided more than $30 billion in financing that would not otherwise have happened in markets that conventional finance would not otherwise reach.

I applaud the agencies for taking this step to undertake a thorough review of the Community Reinvestment Act (CRA) and to consider ways revised CRA rules can increase private investment in rural, urban, and reservation communities across America. I very much appreciate the opportunity to testify today and to be a part of this important conversation.

In recent years, it has become increasingly clear that the nation needs a revitalized approach to the responsibilities outlined in the Community Reinvestment Act—an approach that reflects the seismic shifts in the way financial institutions do business, in the changing needs of their customers, and the increasing reach and sophistication of their partners. This "CRA 2.0" must:

- Update the concept of "assessment areas" to keep pace with the shift in financial institutions' geographic relationship to their customers;
- Support financial institution investment in institutions such as CDFIs; and
- Consider new approaches to considering, evaluating, and crediting community development activities.

The CRA has overall supported community development well. In fact, it has largely defined financial institutions' community development lending and investment activity; it is significantly more difficult to lend and invest in markets that are not included in a bank's CRA assessment area. In practice, underserved submarkets (most often minority and low-income but defined primarily by CRA-shaped geography) comprise the "community" and the provision of financial services is the means to its "development." The CRA has supported countless community development organizations, strategies, and initiatives. It has proved to be a remarkably effective law because it has connected opportunity markets to opportunity capital and financial services.

CRA 2.0

Congress predicated the CRA on one principle and two key facts when it passed the Act in 1977. The principle is core and remains true. The facts point to what can and should change to make the CRA more effective in what has become a different kind of marketplace.

The principle is that banks had an affirmative responsibility to serve everyone in their markets equally well. This principle serves the fundamental precept of our nation—freedom of opportunity and justice for all—and fulfills the purposes of a robust financial services sector.

The first fact is that banks, at the time the CRA became law, had clearly delineated geographic markets—or footprints. The second fact is that the primary business of banks at that time was to provide a prudent savings option for a vast majority of Americans. Various estimates suggest that almost 70 percent of the long-term savings of Americans were in banks in 1977, when Congress passed the CRA. The CRA defined "markets" as those places where banks took deposits.

Since its passage, almost everything having to do with the CRA—and the ideas of "community" and "development" noted earlier—has changed. Competition, technology, product and service innovation, demographics, and consumer patterns and behavior have transformed banking. At minimum, two changes are key: the vast majority of banking is defined around complex consumer demographics rather than geography, and deposit-taking is now a relatively small, while still significant, line of business from the perspective of a bank's financial performance and shareholder concerns. Banking no longer centers around place and savings. Banking today centers around consumer demographics, delivery channels, and product innovations. The rise of online banking services is an indication of the transformation, suggesting that technological tools rather than revolving doors are, or soon will be, the primary way that consumers enter banks.

These shifts in the marketplace require a new way of looking at CRA. The CRA—in a new form, "CRA 2.0"—can be a bank's portal to opportunity markets, the emerging growth markets of coming decades, Communities 2.0. In this 2.0 framework, CRA is no longer a policy for the fringe markets. Instead, it is and should be a core component of economic growth rather than an outlier of economic policy.

Rethinking Markets and Assessment Areas

The CRA still should in most cases apply to geographic markets, but deposit-taking is an obsolete marker for markets. By current estimates, less than 20 percent of Americans' long-term savings now are deposited in banks. The current use of deposit-based assessment areas concentrates CRA obligations in some areas, and leaves other markets underserved. Some rural areas without the brick-and-mortar presence of large financial institutions are effectively "credit deserts; in other areas financial institutions struggle to find the right investments and services. The most recent data from OFN's Membership indicates a sharp disparity between urban and rural CDFIs in the proportion of borrowed capital that comes from financial institutions. In urban-focused CDFIs, the amount of borrowed capital that comes from banks, thrifts, and credit unions is 42%; in rural CDFIs it is just 18%.

A more appropriate and useful definition of financial institution markets, for purposes of the CRA and otherwise, is everywhere each financial institution offers and/or provides products and services and everyone it serves. For example, if a bank offers a credit card to a person—something it can do easily without a brick-and-mortar presence—its CRA responsibility (to provide comparable service for all its products and services) should, in principle, extend not only to that person but to the geographic market where that person lives even when there is no bank branch in that location.

The capacity of the financial services industry to identify markets demographically is extraordinary, and it can be used to create opportunities for low-income and low-wealth individuals. If the market research capacity of institutions involved in targeting subprime customers with questionable products and services were turned to good purpose, for example, financial institutions could compete in "opportunity markets," where nonconforming assets present potential for both incremental and disruptive market gains.

Just as Web 2.0 reflects a current idea of community, CRA 2.0 should do the same. Banks have choices about the markets they will serve, but the markets they choose to serve will define the community reinvestment markets for which they are responsible. As a practical matter, just as the CRA in its current form exempts the smallest banks, CRA 2.0 needs a reasonable minimum standard. Rather than using asset size, however, CRA 2.0 should apply a materiality test. If a financial institution's share of a market is material (that is, at least five percent of the market), it should be subject to whatever the appropriate expectations might be under CRA 2.0. Credit card banks, for instance, target products to particular market demographics. If Capital One held a dominant market share for revolving credit-card products in Southeast Washington, DC, for example, it might carry a commensurate responsibility to provide revolving credit across the demographic and economic spectrum of that market.

New rules around investing in CDFIs and supporting other community development activities, detailed below, could also ensure that all markets are better served by CRA-related activity.

Foster investment in community development

Besides the decreased relevance of the deposit-taking footprint, the other significant change spurring CRA 2.0 is a shift in delivery channels. Under CRA 2.0, financial institutions should use diverse delivery channels to fulfill their responsibilities to their redefined communities. In 1977, banks had few viable delivery channels and relied primarily on successful community development corporations (CDCs) and other nonprofits defined by local geographies. Over the past 30 years sophisticated capital, product, and service delivery channels have emerged, including CDFIs. These delivery channels rely on economic markets more than geography.

CDFIs are private-sector, public-purpose financial institutions that combine mission with market discipline and sound lending practice, successfully executing deals perceived as "high risk." They lend and invest responsibly in urban, rural, and reservation communities across the country, financing small business, affordable housing, and community facilities opportunities often overlooked by other lenders. For decades, CDFIs have met the challenge of providing access to capital and credit in economic turbulence. Financial institutions have been a critical partner in that effort. Bank investment provides a significant portion of the capital that CDFIs use to lend and invest in their markets. But banks get something out of the deal, too: reliable, efficient investment vehicles for both financial and social return; entrance into new markets; co-lending that shares the risk of direct transactions; and not least, of course, credit under CRA.

Examples of such partnerships run the gamut of lending, investing, and service activities across all sectors of lending and in rural, urban, and Native markets, including: a national initiative to foster microenterprise; participation in an innovative public-private loan pool to support the growth of quality, affordable housing opportunities and provide critical seed money for permanent supportive housing developments to help to bring this housing to scale in California, and similar initiatives elsewhere; lines of credit, equity investments, and deposits in CDFIs; support for financial literacy and asset-building programs in Native American communities; and sharing of expertise through service on Boards of Directors and on loan and investment committees. All these activities build stronger CDFIs as well as banks engaged in their communities.

Regulatory considerations that encourage financial institutions to continue to invest in such opportunity finance institutions will extend the reach of CRA. In particular, regulators should provide that an investment into a CDFI helps satisfy a financial institution's CRA obligations regardless of whether the CDFI operates in the institution's assessment area. One simple way to do this is to provide CDFIs the same regulatory treatment afforded to minority- and women-owned depository institutions.

A recent revision to the Interagency Questions and Answers on CRA indicated that the agencies took steps to update the disconnect between markets and assessment areas and channel additional resource to underserved markets by "applying a broader geographic criterion when evaluating capital investments, loan participations, and other ventures undertaken by that institution in cooperation with minority- or women-owned institutions or low-income credit unions. . ."[1] Giving CDFIs the same regulatory treatment will expand CRA even further into those targeted markets, and help update the assessment area and market anachronisms discussed above. Many CDFIs, especially National CDFIs, meet the credit needs of local communities on a state or regional basis. CDFIs are a recognized financial intermediary in the CRA and they are specifically highlighted in Sec. ____.12(h)-1 as an example of community development loans. Providing equivalent treatment for investors is appropriate and a logical step.

In 2008, CDFI customers were 46 percent female, 49 percent minority, and 70 percent low income.[2] By statute, CDFIs must serve the low- and moderate-income communities referred to in the CRA. Both the statutory requirements and the actual performance of Treasury certified CDFIs support the addition of CDFIs to this Q&A and in other communications from the regulators.

As an example, financial institutions in Boston could invest in CDFIs serving rural New England, or those in Charlotte could work with those in the Mississippi delta—CDFIs that could help a bank reach new markets in the region but are outside its investment area. This regulatory change would support CDFIs while allowing banks and thrifts to extend their impact in a region and receive CRA consideration for the investment.

Credit enhancements that support community development financing, including guarantees and letters of credit, deserve similar consideration as equivalent loans or investments. In many cases, credit enhancement is the most appropriate way to address a community need, but the current policy offers only marginal consideration to the bank that provides them. Such a change would allow CDFIs and similar institutions to leverage additional financing into a project or community.

In recent months, though CDFIs have proven to be sound and profitable partners for banks, many

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[1] Most recently published in 75 FR 11642.

[2] Opportunity Finance Network (2010). "Opportunity Finance Institutions Side by Side Fiscal Year 2008 Data and Peer Analysis," 11th Edition, http://www.opportunityfinance.net/store/product.asp?pID=174.

are seeing a retrenching of bank investment in their institutions. Turmoil in the financial services industry threatens the track record of success and partnership between CDFIs and banks that share a target market. As large banks consolidate or disappear, the survivors review their capital strategies, and many are reducing investment in CDFIs or pricing their investments so they are no longer affordable for the CDFI. Respondents to OFN's recent quarterly Market Conditions Surveys have described their concern:

> "The changes within the institutions that are our typical investors were greater than we knew. Credit processes were tightened considerably late last year and early this year. At the same time, credit authority is now held by fewer and different individuals and is at a higher level within each institution. This means it is harder to get decisions and they take longer."
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> "Traditional banking partners reluctant to participate in new pools. Have to seek new participants such as smaller local banks, insurance companies and foundations."

Policy should also recognize that much of CRA 2.0 activity will be either below-market rate (as determined by conventional risk-assessment models) or philanthropic. This touches on a set of questions that are already in play: Is the CRA already diluted by the increasing focus on profitable CRA opportunities? Is there an optimal balance of below-market and market-rate CRA portfolios? What are the parameters for acceptable cross-subsidy strategies by CRA-covered financial institutions, particularly when their financing often involves multiple subsidy streams (such as tax credits)? Revised CRA policy should ensure that financial institutions have an appropriate framework and incentives to make such investments.

Evaluating Community Development

Though CDFI partnerships are a critical piece of CRA 2.0, other delivery channels can and should play an important role alongside such activity. CRA 2.0 should look at economic market channels as well as geographic market channels for CRA, including participating in syndicated or related asset sales with CDFIs; participating in syndicated or related asset sales through other financial institutions with differing capacities within particular markets; participating in municipal or state government financing channels that meet CRA 2.0 standards; or financing CRA 2.0 innovation, research and development, and infrastructure in addition to, not instead of, intermediary financing.

Conducting these activities, and evaluating them under CRA, requires a new approach and one different from the fairly straightforward business of reviewing a bank's activity around affordable housing and small business loans. Real innovation around community development investing and lending requires incentives for financial institutions to conduct it, a variety of options for such loans and investments, and agency understanding of the value and impact of such investments. One approach to making sure this kind of activity gets done is to augment current regulations with a rigorous community development test.

A community development test would evaluate both qualitative and quantitative factors: both the volume of community development loans and investments and their impact. Equity or equity-like investments in CDFIs and other opportunity finance institutions should be a key part of a community development assessment and such investments should confer significant CRA credit. In addition, lending, services and investments in affordable rental housing, economic development projects, community facilities like child care centers and charter schools, community loan funds, microfinance loan funds, "green" financing, and other community development activities *in low-and moderate-income communities* and should qualify for this test.

Such an approach could build upon the other changes I have suggested: the review of community needs required for effective implementation of a community development test will require a more market-based approach to assessment areas. A more explicit review of and focus on community development activity would emphasize CDFIs as valuable partners.

To catalyze these less easily quantified activities, regulators will have to rethink and redesign incentives. There is currently no real incentive to strive for an "outstanding" rating. In addition, financial institutions generally receive favorable consideration for the first time they conduct a community development activity or make an investment, but less incentive to renew or continue it. Incentives for an "Outstanding" rating could include awards for community development leadership and recognition for best practices.

Conversely, refund anticipation loans, payday loans, and other forms of abusive lending should not be rewarded with high grades. The objective of a community development test should be to ensure full access to sustainable, responsible lending products and services.

The community development test would require qualitative judgment about community needs, recognition of innovative approaches, and consideration for the below-market nature of the activities I discussed earlier. Such analysis may be new ground for many examiners who strive to balance safety and soundness considerations with community development activity and are much more familiar with the former than the latter. Training for examiners in community development lending and investing, particularly in understanding the capitalization, accounting, and risk management practices of CDFIs and others is crucial.

Last, even with these improvements CRA 2.0 investors face a significant challenge in finding and using delivery channels. Opportunity Finance Network, my organization, has developed a ratings system for investors in CDFIs with the goal of reducing funding and transaction costs. Still in its early stages, the CDFI Assessment and Ratings System (CARS™) provides investors with normative ratings of CDFI financial risk and performance and impact risk and performance.[3] Ratings reports are detailed quantitative and narrative assessments. The question remains whether CARS™ can or should be adapted to serve other delivery channels or whether other ratings systems might emerge to meet market demand. A ratings system infrastructure to give CRA 2.0 investors transparency and consistency seems both desirable and inevitable.

Conclusion

The CRA's thirty-year track record proves that community reinvestment and safety and soundness can work together to produce results that are good for financial institutions and for their communities. The broad principle of affirmative obligation to serve communities will continue to serve as a foundation while regulatory and implementation changes update CRA to meet the changed—and still changing—needs of markets and communities.

OFN appreciates the opportunity to testify and looks forward to working with you as you work toward CRA 2.0.

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[3] For more information, see www.carsratingsystem.net