Testimony of

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I want to thank the Federal Reserve Board, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision for the opportunity to present some of my thoughts on potential changes to the implementation of the Community Reinvestment Act.

Let me begin by relaying just a bit of my own background. I am a professor in the School of City and Regional Planning at Georgia Tech in Atlanta. Prior to my academic career, I was a senior staff member at the Woodstock Institute here in Chicago for almost ten years - from 1993 to 2002 – where I routinely worked with banks, community groups, and regulators around issues of CRA implementation. Earlier, I was a community development practitioner working on issues of development finance and reinvestment more generally.

Since the early 1990s, I have been active in studying the implementation and effects of the Act, and recommending changes to the Act and its implementation. I have authored dozens of studies on issues related to community reinvestment, access to credit and financial services, and fair lending, including many peer-reviewed articles. Moreover, I have written three books, one of which was essentially a policy history of CRA and fair lending issues in the U.S.[2]

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[2] D. Immergluck. *Credit to the Community: Community Reinvestment and Fair Lending Policy in the U.S.* Armonk, NY: M.E. Sharpe. 2004.

Before I address specific issues that I believe are critical to making CRA more effective, I would like to begin by commending the officials at your agencies for continually pointing out how CRA fostered sound lending in lower-income neighborhoods and did not contribute to the subprime crisis. Early on in the crisis, I think many serious observers of mortgage markets – even some who oppose the Act or various aspects of its implementation – assumed such arguments would die out quickly, smothered by the weight of common sense and the opinions of experts in the mortgage industry and elsewhere. Unfortunately, they did not. Even after rigorous research has eviscerated the persistent blaming of the Act, such misplaced assertions persist.[3] It appears likely that it will take additional efforts to counter such misinformation.

I have been asked to focus my comments on a couple of key issue areas, including the topic of geographic coverage and assessment areas, and the nature, composition and execution of CRA performance evaluations, including the assessment of affiliate activities.

Overall, CRA implementation effectively suffers from covering an ever-decreasing share of mortgage and financial services markets and from inconsistent and undulating enforcement. The portion of the mortgage market that is subject directly to CRA (originated by depositories) declined markedly in recent decades. For home purchase loans, the share of all home purchase loans made by CRA regulated institutions fell from 36 to 26 percent over the 1993 to 2006 period.[4] For refinance loans, the share fell from 45 to 25 percent.

With respect to the consistency of enforcement, the inconsistencies in the implementation of CRA have allowed for weakened and undulating enforcement of the law. Data from the Federal Financial Institutions Examination Council shows that the share of institutions receiving Outstanding CRA ratings varied greatly across regulatory agencies, especially in the middle 2000s. The proportion of institutions regulated by the Office of Thrift Supervision receiving Outstanding ratings from 2004 to 2007 ranged from approximately 25% to 35%, while for the FDIC, the figure fell in the 7-15% range.[5] In my own work, in an analysis of the Investment Test results on almost 200 CRA performance evaluations, I found that institutions regulated by the OTS made far smaller levels of

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[3] For a review of the literature on whether CRA had a role in the mortgage crisis, see U.S. Department of Housing and Urban Development, *Report to Congress on the Root Causes of the Foreclosure Crisis*, January 2010. Retrieved February 1, 2010 at http://www.huduser.org/portal/publications/hsgfin/foreclosure_09.html.

[4] R. Essene and W. Apgar. The 30th Anniversary of the Community Reinvestment Act. In *Revisiting the CRA: Perspectives on the Future of the Community Reinvestment Act*. Federal Reserve Banks of Boston and San Francisco, February 2009, pp. 12-29.

[5] R. Avery, M. Courchane, and P. Zorn. The CRA within a Changing Landscape. In *Revisiting the CRA: Perspectives on the Future of the Community Reinvestment Act*. Federal Reserve Banks of Boston and San Francisco, February 2009, pp. 30-46.

investments than those regulated by the other agencies, after controlling for asset size, region of the country and performance on the lending and service tests. [6]

I now turn to specific issues in no particular order:

Affiliate Activities, CRA coverage, and assessment areas

Mortgage markets have changed dramatically since the adoption of the Act. In recent decades, the industry has generally consolidated, with large national lenders accounting for greater and greater market share.[7] During the 1980s and 1990s, the growth of nonbank mortgage companies meant that more lenders were not subject to CRA. However, the growing dominance of large, nationwide bank holding companies in the mortgage market, which sometimes occurred in part due to the acquisition of formerly independent mortgage companies, could have provided an opportunity for improving CRA coverage.

However, the failure to modernize CRA to keep up with the changing structure of the mortgage market has resulted in adverse impacts on CRA coverage. Currently, CRA coverage in the mortgage market is actually quite ambiguous and at least partially determined by the composite desires and choices of the regulated entities themselves. That is, the lending of bank-affiliated enterprises is "included" in CRA performance evaluations largely at the choice of the examined bank. While there are efforts to limit "cherry picking" by regulated institutions, the examination procedures continue to allow regulated entities to include the loans of their affiliates at their option; this suggests that such loans will be included only if they are expected to improve the banks CRA test results. This makes little sense. When I give an exam, I do not allow students to instruct me as to what the exam may cover.

- *Evaluate CRA performance at the level of the bank holding company*

To help remedy the problem of declining CRA coverage and to rationalize the CRA process, CRA examinations should be conducted on a bank holding company level.[8] That is, there should be a single CRA examination for each bank holding company and the assessment area(s) should be determined based on the lending patterns of the holding company as a whole. If it is not possible to require that nonbank affiliates be included in the BHC umbrella for CRA evaluation purposes, and a lender is still given the

[6] See D. Immergluck, Out of the Goodness of their Hearts? Regulatory and Regional Impacts on Bank Investment in Housing and Community Development in the United States. *Journal of Urban Affairs* 20 (2008): 1-30.

[7] R. Essene and W. Apgar, 2009.

[8] There would, of course, be practical implications of implementing BHC-wide CRA evaluations. One question that would likely arise involves which agency would be responsible for conducting the evaluation. One approach would be to have interagency teams conduct the evaluations, with the team leadership coming from the agency responsible for the largest portion of BHC assets.

option to include affiliates, it should be required to include all affiliates for all product lines.

- *Each bank holding company should have one global assessment area (comprised of aggregated localized assessment area components) based on the activity patterns of all BHC entities.*

Ideally, assessment areas should be based on the lending patterns of all BHC entities, including mortgage company affiliates. It makes little sense to define areas based on only one part of a BHC's business line, simply because it is originated via a depository unit vs. a nondepository unit.

- *Assessment areas should be market-based.*

Assessment areas should be developed based on an analysis of market penetration. For metropolitan areas, the market analysis should be conducted on the MSA level; for rural areas, it should be conducted on the county level. An MSA should be included in an assessment area if: 1) the BHC originates an appreciable share of loans in that MSA (e.g., 0.05% as proposed in HR 1479 and as recommended by the National Community Reinvestment Coalition); or 2) the MSA is among those MSAs accounting for the bulk of the BHC's lending activities.[9] This analysis should be done for all major product lines (mortgages, small business loans, e.g.). The same process should then be used for determining which nonmetropolitan counties should be included in the assessment area.

Unfortunately, while this sort of analysis can be readily performed for mortgage markets and, with some limitations, for small business lending (at least for large banks), it is not generally possible – at this time – for deposit services given the lack of comprehensive, geographically specific data on deposits.[10] Bank branches can be analyzed, but are severely limited as proxies for deposit services. Without such data, developing appropriate assessment areas for the Service Test will remain difficult. To implement the Service Test in an adequate fashion, regulators need to promulgate rules for the collection and disclosure of data on basic financial services, including deposit accounts.

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[9] For example, MSAs or rural counties might be deemed to be included in those "accounting for the bulk of the BHC's lending activities" as follows. If an MSA (or rural county) lies in the top 75th percentile of MSAs (or rural counties) when ranked by mortgages (or small business loans) originated by the lender, it would be included in the BHC's assessment area. For some small banks, the market share penetration threshold may prove inappropriate, especially in large MSAs where they may tend to attain very low market shares. The second criteria of including MSAs or counties that account for the bulk of the bank's lending activity should serve as the primary criteria for assessment area definition in such cases.

[10] With the passage of the Dodd-Frank Act, and the new requirement that small business loan data be collected for all small business lenders, regulators should have access to a new, far superior tool to assess CRA performance in the small business lending area.

Establishing a more consistent basis for performance contexts and identifying community credit and banking needs

One challenge that the agencies have routinely faced is evaluating a financial institution's CRA performance in the context of the credit and financial services needs of the local communities it serves. This becomes a particularly difficult task in evaluating institutions whose assessment area span across multiple MSAs or states. One promising suggestion made at the July 19 CRA hearings that I recommend expanding upon is to develop well-researched, interagency community development needs analyses for a set of 50 large MSAs and for the remaining balance of each state.[11]

Such an approach makes a good deal of sense but should be expanded beyond assessing performance under the Community Development (or Investment) tests as proposed by Rubinger (see footnote 11). This approach could be used to provide more thorough, rigorous, and consistent information to be shared by all examiners conducting exams in these areas. I would also recommend expanding the list of MSAs to something more like the top 100 MSAs rather than simply the top 50. This would not only provide more localized knowledge for the mid-sized and smaller MSAs, but would result in the balance-of-state analyses to more heavily consider needs in rural or small city areas.

Such a rationalization of resources should provide for more consistency across examinations and regulatory agencies, and provide for deeper and more meaningful assessments of credit and banking needs in various communities.

Improve the qualitative aspects of CRA evaluation and sharpen, but do not reduce the use of, quantitative assessment methods

Some commentators have suggested that CRA evaluations have become too "numbers-driven," so that lenders are too heavily rewarded for amassing large numbers or shares of low-impact loans, investments or services while receiving insufficient credit for more complex and innovative activities or for activities that are particularly effective at serving a community's credit or financial services needs.[12] Such perspectives raise some valid concerns. Efforts to quantify results in almost any evaluative context typically run into what researchers refer to as "validity-reliability tradeoffs," in which attempts to develop consistent, reliable and accurate indicators (typically involving quantitative

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[11] Rubinger, M. Statement of Michael Rubinger, President and CEO, Local Initiatives Support Corporation. Community Reinvestment Act and Community Development. Community Reinvestment Act (CRA) Interagency Joint Public Hearing. July 19, 2010. Arlington, VA.

[12] See, for example, J. Jacokes, Testimony on behalf of the Community Development Bankers Association and CDFI Coalition before the Federal Financial Institutions Examination Council (FFIEC) Hearing on Proposed Revisions to the Community Reinvestment Act Regulations. Arlington, VA. July 19, 2010; and M. Willis, "It's the Rating Stupid. A Banker's Perspective on CRA." In *Revisiting the CRA: Perspectives on the Future of the Community Reinvestment Act*. Federal Reserve Banks of Boston and San Francisco, February 2009, pp. 59-70.

data and tools) inevitably yield indicators that do not fully capture the phenomena of interest. For any complex phenomenon, no discrete list of a few quantitative measures will present an entirely "valid" picture of the phenomenon. This is why evaluators and researchers frequently employ mixed methods of evaluation and assessment; they seek qualitative information to complement the quantitative data.

The answer to the imperfect validity of quantitative measures, however, is not to eschew quantitative indicators. Avoiding quantitative measures is likely to result in greater problems of reliability in assessments, including much higher levels of inter-rater reliability, in which consistency across examiners and agencies is likely to become even a greater problem than it is already. Moreover, reducing the use of quantitative measures may imperil accountability among regulators and institutions and lead to an overall leveling down in the rigor of exams. Finally, while it is important to give appropriate weight to community development activities and to reward institutions who go "further" in their efforts to meet community credit and financial services needs, avoiding quantitative measures of mainstream retail loans and services is not the best approach for recognizing such differences.

A better approach is to rationalize and improve the quantitative indicators as much as possible and to combine qualitative and quantitative methods, especially in the analysis of community development activities or investments. For example, Willis echoes previous criticisms of Investment Test implementation by arguing that examiners should not treat a dollar of market-rate or near-market-rate, low-risk investment in a community development activity in the same way that a dollar of grant money or high-risk, below-market-rate investment is treated.[13] This is certainly a strong argument and is one that might be partly addressed through a categorization of investments by risk and return and perhaps some sort of weighting or disaggregated analysis.

Develop procedures to measure the quality of CRA-eligible loans and services.

One flaw in CRA implementation during the 1990s and 2000s was the failure of regulators to consider the quality of institutions' lending activities and to make a determination as to whether some portions of lending was, in fact, having detrimental impacts on local communities and households.[14] While the great bulk of subprime lending was not under the purview of the CRA, if some of the changes recommended

[13] Willis, 2009.

[14] For example, in his written testimony at the July 19 CRA hearing in Arlington, VA, Calvin Bradford, a veteran of two decades of monitoring CRA evaluations, states: "I have never seen a single CRA public examination report that has penalized a national bank for disproportionately concentrating subprime loans in minority or low and moderate-income areas. In addition, I have never seen a CRA examination report that even indicates that the Comptroller has reviewed a bank's provision of lines of credit to the subprime or payday lending industry or that the Comptroller has examined the bank's role in the securitization of toxic loans." From: C. Bradford, Statement of Calvin Bradford, President, Calvin Bradford & Associates, Ltd. before the Public Hearing on the Community Reinvestment Act Regulations, Arlington, Virginia, July 19, 2010.

here are adopted, including expanding assessment areas and examining all lending of BHCs regardless of particular channel, it may become more important to consider variations in the affordability, quality and responsibility of lending and financial services products across different communities.

The challenge here is substantial; I am in no way suggesting that considering the "quality" of retail lending is a trivial task. Promulgating standards for practices or products that are deemed as not beneficial or potentially harmful to local communities is not without likely controversy, and bright lines are not always possible. Nonetheless, methods and approaches can be adapted from fair lending and other compliance examination procedures (and applied on a geographic basis). For example, regulators should pull random samples of loans from different channels or units of a lender (or BHC) and identify any differences in terms and pricing. Combining this work with analyses of where and to whom different units originate loans should then be used to evaluate how well the BHC as a whole serves lower-income communities vs. other communities. The same sorts of analyses should be routinely done with consumer financial services.

One new tool that could be used to measure loan quality in the mortgage market is the identification of "qualified mortgages," to be implemented under the Dodd-Frank Act. Examiners should give greater weight to the origination of qualified mortgages in low- and moderate-income communities than to the origination of non-qualified mortgages.

Of particular interest should be the delinquency and default rates of loans originated by the BHC, including all channels. Institutions should maintain reports on the delinquency and default rates of originated loans, regardless of whether the loans remain in portfolio, and be able to identify default rates across different geographies (e.g., low, moderate, middle and upper-income census tracts). Such analysis should also be broken out by origination channel (wholesale, correspondent, retail) and by lending unit. Institutions with default rates substantially above industry norms should not receive CRA credit for the corresponding product line, and high default rates should result in lower CRA ratings.[15]

Thank you for this opportunity to share my perspectives on some ways to strengthen the Community Reinvestment Act.

[15] It is important here not to go too far. Modestly higher default rates should not be heavily penalized. I am suggesting penalizing origination activity with orders of magnitude higher default rates such as those exhibited by many subprime lending units in the 1990s and 2000s. Some multiple of FHA default rates, for example, might be used as a benchmark for mortgages.