Comments of Housing Research & Advocacy Center regarding Assessing Bank Performance Under the CRA

August 31, 2010

The Housing Research & Advocacy Center (the "Housing Center"), a non-profit fair housing/fair lending organization based in Cleveland, Ohio, and a member of the National Community Reinvestment Coalition, wishes to submit the following comments regarding the proposed regulatory rulemaking on the Community Reinvestment Act (CRA).

The CRA has come under attack from many in recent years as an alleged cause of or contributor to the subprime lending and foreclosure crisis. While research has clearly shown this to be untrue, what is accurate is that gaps in CRA coverage, combined with lax enforcement of the statute, were contributing factors to the crisis. In order to avoid a repeat of the recent (and, in many communities, ongoing) mortgage and foreclosure crisis, it is crucial that the regulations underlying the CRA be strengthened and that the agencies charged with regulating mortgage lenders actually regulate these institutions.

In considering regulatory changes to the regulations implementing the CRA, the Housing Center believes that a regulatory rulemaking should address the following areas:

I. Geographic Coverage

Under the current CRA regulations, assessment areas (the geographical locations covered by CRA exams) generally consist of metropolitan areas or counties in which a lender maintains a branch presence. While some banks still issue loans predominantly through branches, others make the majority of their loans through brokers and other non-branch means. In the Cleveland area, some mortgage lenders who issued numerous loans had no branch presence in the region and therefore the Cleveland region was not considered part of their assessment area.

As a result of the current definition of assessment areas, the share of all home purchase loans made by banks operating in their CRA assessment areas has dropped to about 25 percent.[1][1][1] Narrow assessment areas facilitate problematic lending practices that are not scrutinized on CRA exams. Research demonstrates that lending by institutions not covered by CRA or by banks outside of their assessment areas are more likely to be high-cost.2[2][2]

II. Require Inclusion of Affiliate Activities

Under the CRA, banks have the option of including their non-depository affiliates, such as mortgage companies, on CRA exams. Making such reporting optional practically invites lenders to "game" the system. Banks are tempted to include affiliates on CRA exams if the affiliates perform admirably, but will opt against inclusion if the affiliates are engaged in risky lending or

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1[1][1] Ren Essene & William C. Apgar, Harvard University, "The 30th Anniversary of the CRA: Restructuring the CRA to Address the Mortgage Finance Revolution," in *Revisiting the CRA: Perspectives on the Future of the CRA*, Prabal Chakrabarti et al., eds., Federal Reserve Banks of Boston and San Francisco, 2009.

2[2][2] Robert B. Avery, Kenneth P. Brevoort, and Glenn B. Canner, "Higher-Priced Home Lending and the 2005 HMDA Data," *Federal Reserve Bulletin*, Fall 2006, p. A154.

discriminatory policies. The regulations should be revised to require that examiners consider activities of all affiliates of an institution to ensure that the institution is meeting its obligation to meet consumers' credit needs in a safe and sound manner.

III. Include Bank Lending and Service to Minorities on CRA Exams

Given the evidence of lending disparities by race,3[3][3] we believe that CRA exams must explicitly examine lending and services to minority borrowers and communities. A large body of research shows that minorities received larger percentages of subprime loans than whites, even after controlling for borrower creditworthiness and other characteristics.[4[4][4]] Overall, it is probable that considering lending and branching by race of borrower and neighborhood on CRA exams would lessen the racial disparities by encouraging banks to increase their lending and services in communities of color. Before the 1995 changes to the CRA regulation, CRA exams considered lending to minorities as an assessment factor, suggesting the agencies thought they had the authority to consider lending to minorities on CRA exams.

IV. CRA Exam Ratings and Weights

The scale of four possible ratings does not provide meaningful distinctions in performance and has resulted in a 98 to 99 percent pass rate over the last several years. Further, institutions have no incentive to improve their practices (which, as is evidenced by the mortgage and foreclosure crisis, have been deficient in many ways) if virtually all institutions are rated satisfactorily. The agencies should introduce Low and High Satisfactory as possible ratings in addition to the four existing ratings. In addition, the agencies should develop better weighting systems so that routine investments like purchasing loans on the secondary market do not receive as much weight as more difficult investments such as equity investments in small businesses.

We do not believe that major changes in CRA examinations are desirable. Some will argue that more banks should be eligible for streamlined exams; we believe that the recent changes went too far in making exams too easy for mid-size banks. Rigorous exams require more safe and sound lending from institutions.

V. CRA Enforcement Mechanisms

Mergers have traditionally been a major means of CRA enforcement, but the frequency of mergers are likely to continue decline over the next several years. Consequently, additional

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3[3][3] The Housing Research & Advocacy Center has produced a number of reports addressing racial disparities in mortgage lending in Ohio. *See, e.g.*, HRAC, "Racial and Ethnic Disparities in 2008 Ohio Mortgage Lending" (December 2009); HRAC, "Continued Racial and Ethnic Disparities in Ohio Mortgage Lending" (2008), both available at www.thehousingcenter.org. In addition, research by the Center for Responsible Lending and the National Community Reinvestment Coalition has likewise found similar disparities. *See, e.g.*, NCRC & NCNW, "Income is No Shield, Part III, Assessing the Double Burden: Examining Racial and Gender Disparities in Mortgage Lending," (June 2009); Bocian, Ernst & Li, "Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages," CRL (May 31, 2006).

4[4][4] NCRC*, Foreclosure in the Nation's Capital: How Unfair and Reckless Lending Undermines Homeownership*; Paul S. Calem, Kevin Gillen, and Susan Wachter, *The Neighborhood Distribution of Subprime Mortgage Lending* (October 30, 2002), available via pcalem@frb.gov. *See also* Paul S. Calem, Jonathan E. Hershaff, and Susan M. Wachter, *Neighborhood Patterns of Subprime Lending: Evidence from Disparate Cities*, in Fannie Mae Foundation's Housing Policy Debate, Volume 15, Issue 3, 2004, pp. 603-622.

4[4][5] *See* FDIC CRA exam of CIT Bank of May 2008. The bank failed because it purchased high levels of problematic subprime and non-traditional loans. http://www2.fdic.gov/crapes/2008/35575_080512.PDF.

enforcement mechanisms are needed. For instance, banks could be required to submit CRA improvement plans, subject to public comment, when they receive either a low rating overall or in any assessment area. CRA exams and merger approval orders could include an "expectations section" that either mandates or recommends (depending on the extent of the deficiency) improvements to specific aspects of CRA performance such as a particular type of lending or investment.

The agencies must also boost the rigor of the fair lending reviews that probe for evidence of illegal and discriminatory lending. Fair lending reports on CRA exams must be detailed explanations of the fair lending tests used instead of the one or two sentences currently on most CRA exams. In addition, the concept of illegal and discriminatory lending must be expanded to include unsafe and unsound lending. Banks have failed CRA exams because they made or financed unsafe loans; the fair lending review must routinely indicate whether the review found evidence of unsafe and unsound loans.5[5][5]

Some commentators will favor "incentives" to coax institutions into improved CRA performance. We would be supportive of exploring programmatic methods to increase tax credits under the Low Income Housing Tax Credits or New Markets Tax Credit for institutions receiving Outstanding ratings. But we are opposed to exemptions from CRA review on merger applications or decreasing the frequency of CRA exams for institutions with Outstanding ratings. CRA performance is likely to decline when institutions receive less frequent exams and public scrutiny.

VI. Data Enhancements

By holding lenders accountable, publicly available data, particularly the Home Mortgage Disclosure Act, has been vital for increasing responsible lending to traditionally underserved borrowers. The amount of data should be increased to include additional elements, such as the specific addresses of REO property that is owned or being serviced by an institution.

The CRA small business data should be enhanced to include the race and gender of the small business borrower. In addition, the agencies must require census tract level disclosure of community development loans and investments. In order to promote access to basic banking services, the agencies must require disclosure of enhanced data that shows types of deposit account (such as basic lifeline) by census tract location of the residence of bank customers. Likewise, data on the type consumer lending by borrower demographics and census tracts can promote access to affordable consumer loans and alternatives to abusive payday loans. Improvements in data disclosure will enhance the ability CRA exams to assess if banks are responsive to the full range of credit needs of communities.

VII. Community Development Investing Outside Assessment Area

Some have suggested that banks receive favorable CRA consideration for investing in multi-regional funds for Low Income Housing Tax Credits and other purposes. In the interest of serving diverse geographical areas including rural areas, we are supportive of these suggestions as long as banks have adequately responded to the needs in their assessment areas. A bank could be required to have a rating of Outstanding on the investment test in most assessment areas, for

example, before being allowed to invest outside of their assessment areas in multi-regional funds.

Conclusion

The severity of the foreclosure crisis would have been substantially lessened if the entire financial industry had an obligation to serve all communities consistent with safety and soundness. We believe that the regulatory agencies can contribute significantly to ensuring sustainable economic recovery by updating the CRA regulation.

Sincerely yours,

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