BUSINESS & TRANSPORT SECTION

Community Reinvestment Act (USA)

Last Updated 17 April 2000 *[finance\CommunityReinvestmentAct -cpb]*

The Community Reinvestment Act (CRA) in the USA is sometimes cited as a model for regulating the relationship of banks and other financial institutions with their communities. The Act was passed in 1977 originally, but has since been adjusted. Its aim is to ensure that banks help meet the credit needs of all sectors of their communities: it was originally introduced to prevent the alleged practice of banks refusing to lend to certain areas (‘redlining).

A bank’s CRA assessment may be critical to whether the regulators permit it to open a new branch, or to merge or acquire another bank. The process of assessment has encouraged banks and the regulators to focus on meeting the various assessment criteria. Assessment includes provisions for public input, and the CRA records of every financial institution are readily available.

One of the elements which is assessed under the CRA is an institution’s record on branch openings and closures, and it is in the context of branch closures that the CRA is currently being discussed in the UK. Whilst the branch record will influence the CRA rating, and that rating will be taken into account when regulatory permissions are sought for certain actions, the CRA itself does not prevent banks from closing branches. Moreover, the soundness of the institution is not to be prejudiced by the evaluation criteria. The CRA specifically states that the assessed community record must be consistent with the safe and sound operation of the institution.

Whilst its proponents, which include the current US administration, argue that the CRA has been very effective at channelling loans and financial services to disadvantaged areas, its critics argue that the procedures are unnecessarily onerous for banks and that its requirements distort lending decisions which would be better guided by market forces. In the UK, the introduction of a similar measure has been called for in a Private Member’s Bill introduced by Tony Colman.[1] The UK Government is on the record as saying that it does not believe that legislation on the lines of the CRA would be appropriate here. [2]

---

[1] *Community Reinvestment Disclosure Bill* [Bill 231 1997-98]
[2] HC Deb 15 March 15 2000 cc 104-5WH

Aims of the CRA

The Community Reinvestment Act was introduced in 1977 and revised in 1995. Its aims have been summarised by one of the US banking regulators, the Federal Reserve Board, as follows:

> The Community Reinvestment Act is intended to encourage depository institutions to help meet the credit needs of the communities in which they operate, including low- and moderate-income neighborhoods. It was enacted by the Congress in 1977 (12 U.S.C. 2901) and is implemented by Regulation BB (12 CFR 228). The regulation was revised in May 1995.
>
> The CRA requires that each depository institution's record in helping meet the credit needs of its entire community be evaluated periodically. That record is taken into account in considering an institution's application for deposit facilities.
>
> Neither the CRA nor its implementing regulation gives specific criteria for rating the performance of depository institutions. Rather, the law indicates that the evaluation process should accommodate an institution's individual circumstances. Nor does the law require institutions to make high-risk loans that jeopardize their safety. To the contrary, the law makes it clear that an institution's CRA activities should be undertaken in a safe and sound manner.
>
> CRA examinations are conducted by the federal agencies that are responsible for supervising depository institutions. [The depository institutions which are supervised by the Federal Reserve are] mainly state-chartered banks that are members of the Federal Reserve. CRA information on other depository institutions is available from the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS). Interagency information about the CRA is available from the Federal Financial Institutions Examination Council (FFIEC).[3]

Under the CRA procedures, each bank is examined under community reinvestment criteria by one of the four federal supervisory agencies. Examinations take place about every two years for larger banks, and about every four to five years for small banks. The examination procedure requires the bank to submit detailed information about its lending patterns, local investment and service standards.[4] Emphasis is placed on serving the whole community. Each institution is assigned an assessment area, which covers the localities whose needs it might be expected to serve. For that area, the geographical distribution of loans (including the proportion of loans which go to areas of low, moderate and upper income), and the distribution of loans according to borrower characteristics (including loans to small businesses and farms, as well as loans to those on low and moderate incomes), are recorded.

---

[3] http://www.bog.frb.fed.us/DCCA/CRA/

[4] The procedure described here is used for large banks; there is a more streamlined procedure for small banks, and some institutions are assessed against their own published CRA strategic plans instead. Each procedure is broadly intended to evaluate similar factors.

The lending test is weighted to make it twice as important in determining the overall CRA rating as the other two tests, the investment test and the service test.

The service test is the most relevant to the UK debate on branch closures. As part of evaluating the service provided to the community, the assessment looks at how branches are distributed between localities of low, moderate or upper income within the assessment area. The bank's record of opening and closing branches, especially those in locations which are classified as low to moderate income ones or which serve individuals on low to moderate incomes, is taken into account, as is the effectiveness of alternative delivery mechanisms for low and moderate income areas and individuals. The degree to which the services provided are tailored to meet the needs of the area is also evaluated. Extracts from a real CRA assessment are contained in an annex to this note.

A public CRA file which contains detailed information about the bank's community activities has to be maintained by all banks. It is available at the bank's main office, or at one branch in each state in which the bank operates. Limited CRA information, including the most recent evaluation and information on the assessment area in which the branch is located, has to be made available at each branch. Banks display notices which inform the public about the information which is available, and which gives details about the assessment procedure. Comments received by the bank from the public about its CRA performance have to be held on the public file.

How effective has the CRA been?

The US Department of the Treasury supports the role of the CRA:

> CRA has proven its worth. It is working to restore healthy markets in distressed communities. Nonprofit community groups estimate that since 1992 the private sector has pledged over $397 billion in loans going forward for community development, which represents over 89 percent of CRA pledges made since CRA's enactment in 1977. In 1996 alone, large commercial banks made nearly $18 billion in community development loans, in addition to the affordable housing loans reported under the Home Mortgage Disclosure Act and small business loans reported under CRA.[5]

Recently, as an addendum to a report on a financial services reform Bill, some Democratic members of the Senate Banking Committee listed the achievements of the CRA as they saw it, including the following points:[6]

> CRA has significantly improved the availability of credit in historically underserved communities. CRA has been credited with a dramatic increase in home ownership by low- and moderate-income individuals. Between 1993 and 1997, private sector

[5] 'The Treasury's principal concerns about H.R.10', Department of the Treasury press release, 27 March 1998

[6] 'Additional views of Senators Sarbanes, Dodd et al: Community Reinvestment Act', *Financial Services Modernization Act of 1999*, Senate Banking Committee, Senate report 106-44, March 1999

> conventional home mortgage lending in low- and moderate-income census tracts increased by 45%. [7]
>
> CRA has also helped spur bank and thrift investment in multi-family rental housing development and rehabilitation and community economic development. In 1997, large banks and thrifts made approximately 525,000 small business loans totaling $34 billion to entrepreneurs located in low- and moderate-income areas.[8] Commercial banks and thrifts also invest in community development projects--nearly $19 billion in 1997 alone. [9]

The CRA does, however, come in for criticism; both from organisations representing sectors of the community who should be helped by the Act, and from those who think the system is too bureaucratic and formalised. As the New York community rights group Inner City Press/Community on the Move notes, the CRA evaluation procedure results in favourable gradings for the vast majority of banks. Some question whether this adequately reflects the realities of community finance, or whether it means that the thresholds are set too low:

> As the statute makes clear, the CRA is ***only*** enforced in connection with banks' merger and expansion applications. The federal bank regulatory agencies periodically evaluate banks for their compliance with CRA, and assign them one of four ratings: Outstanding, Satisfactory, Needs to Improve or Substantial Non-Compliance. In 1998, the agencies rated over 98% of banks as either Outstanding or Satisfactory, despite that fact that, for example, the banking industry continues to deny the mortgage loan applications of African Americans and Latinos twice as frequently as those of whites. Statistics about loan approvals and loan denials can be determined by using the Home Mortgage Disclosure Act (HMDA) data that banks are required to make public each year. [10]

Nevertheless, the same organisation admits that the CRA can be a useful weapon for community organisations, both in terms of requiring banks to publish information on community policies and achievements, and because it offers an opportunity to challenge aspects of the evaluation process (such as which localities should be included in the crucial assessment area for each bank):

> Despite that fact that the regulators have been largely "captured" by the banking industry, CRA can sometimes be enforced in a way that benefits our communities, particularly when grassroots community groups challenge bank-on-bank merger and expansion applications. When banks apply to buy another bank, or to otherwise expand, CRA requires the regulators to consider the applicant bank's record of serving low and moderate income communities.

---

[7] Attachment to FFIEC Press Release, August 6, 1998 (Table 7).
[8] Attachment to FFIEC Press Release, August 24, 1998 (Table 4.2).
[9] Attachment to FFIEC Press Release, August 24, 1998 (Table 5).
[10] Inner City Press (www.innercitypress.org/cra.html)

> There are public comment periods on these applications; if community groups document the bank's failure to fairly serve their area, the regulators are required to look more closely, and take action. Some banks make commitments as to the amount and type of loan products and banking services that the bank will make available. [11]

Other critics of the CRA argue that it is a bureacratic procedure which places large reporting burdens on banks which are disproportionate to the benefits which communities derive from the regime. For example, a persistent critic George J. Bentson has argued in a paper for the Cato Institute that it would be more responsible to repeal the Act, since it harms consumers by adding to the costs of banking:

> HMDA [Home Mortgage Disclosure Act] and CRA have yielded few benefits to consumers. Researchers using the best available data find very little discernible home-mortgage lending discrimination based on area, race, sex, or ethnic origin. Furthermore, inter-state banking; wider branching; and improved technology, which has engendered nation-wide— indeed, global—competition, have meant greater availability of mortgage loans. Today there is no indication that qualified borrowers are turned down.
>
> Further, many large banks "cream skim," that is, make loans to the better credit risks in central cities and to minorities to meet CRA requirements. This practice takes business from smaller, often minority-owned banks that have traditionally served those communities and clients.[12]

Community finance comparisons with the UK

As part of the work of the Social Exclusion Unit, a team in the Treasury recently compared community finance provision in the USA with that in the UK. It concluded that although the market for community finance was more developed in the USA, the disparity was not as great as might be thought. The Community Reinvestment Act is cited as one of the factors creating greater provision in the USA:

> 3.28 The US market for community finance is somewhat more developed than in the UK. This springs from a wide range of factors, including:
>
> - a tradition of local banking and local bank regulation, which gives banks a greater stake in their local economy and offers a geographically-focussed policy lever to bank regulators;

[11] Ibid

[12] George J. Benston, 'The Community Reinvestment Act: Looking for discrimination that isn't there', *Policy Analysis*, Cato Institute, 6 October 1999

- more widespread and active participation of community organisations in urban regeneration, with a more entrepreneurial and commercial attitude to seeking finance;

- greater partnership between community financiers and commercial banks to provide "patchwork finance" for such schemes;

- a challenging approach from the Federal government, involving both prescriptive legislation (Community Reinvestment Act 1977) placing obligations on US banks, as well as incentives for commercial lenders to become involved (eg Small Business Administration loan guarantee schemes, Bank Enterprise Award scheme) and publicly-funded support for community organisations (eg Community Development Finance Institutions Fund).

3.29 The scale of community finance is correspondingly greater than in the UK. According to the National Community Capital Association, there are around 350 community development finance initiatives across the US, with $2-3 billion available for lending. The US initiatives can be categorised roughly as:

- community development banks (about 10);

- credit unions (130+);

- loan funds (46);

- micro finance funds (50+);

- neighbourhood equity funds.

3.30 Compared to the £34 trillion assets of the mainstream financial services industry in the US, the activities of community finance initiatives are however still marginal. As an indicator of market development, scaling these figures for the relative sizes of the UK and US economies would give £200-300 million for lending in the UK, if community finance were as developed as in the US. This range compares to the estimate of £170m of capital available for enterprise lending by community finance initiatives in the UK.[13]

The Government, in the debate about branch closures, appears to have ruled out legislation as a means of regulating the provision of bank outlets:

(**Chris Mullin**) The right hon. Gentleman asked me about some legislation in the United States of America. We have briefly considered that, but we do not see that legislation would help to solve the problem. We are watching progress in the area, but there is no evidence that the US legislation has led to better access to banking in rural areas. More than 20 years after the community reinvestment legislation, the

---

[13] *Enterprise and social exclusion*, Report of Policy Action Team 3, HM Treasury, November 1999

percentage of the US population without any kind of bank account is twice as high as it is in the UK, where we do not have such legislation. The difficulties, and the distances, are on a wholly different scale in the US, but legislation may not be the right way to proceed. [14]

[14] HC Deb 15 March 2000 cc 104-5WH

Annex: Example of CRA rating, with special reference to branch closures

The CRA evaluations of US banks are readily available on the internet from the four bank supervisory bodies.[15] Most banks receive a rating of either 'Outstanding' or 'Satisfactory': a very small proportion receives a 'needs to improve' or 'substantial non-compliance' rating. The three tests on which large banks are rated are the lending test, the investment test and the service test. The assessment is weighted to make the lending test twice as important as the other two tests. Branch services are assessed largely under the 'service' test which has four components: accessibility of delivery systems; changes in branch locations; reasonableness of business hours and services in meeting assessment area's needs; and, community development services.

Because performance is unlikely to be consistent on all characteristics of the three tests, the rating for a particular characteristic may not be the same as the overall CRA rating. Under the characteristic of 'changes in branch locations', a bank would receive an 'outstanding' rating if its record of opening and closing branches had *improved the accessibility of its delivery systems*, particularly to low and moderate income areas and low and moderate income individuals (LMI). A 'satisfactory' rating would be obtained if its record *had not adversely affected* (high satisfactory) *or not generally adversely affected* (low satisfactory) these LMI categories. The rating would decline to 'needs to improve' if the record had *adversely affected* these groups, and to 'substantial noncompliance' if it had *significantly adversely affected* them.

Because most banks receive ratings of satisfactory or above, and because banks are assessed on a number of different characteristics, it is hard to find a CRA rating where branch closures had a significant effect on the overall rating.

Consider for example, the evaluation of the CRA performance of a Californian bank, based in San Marino with seven branches, carried out by the Office of the Comptroller of the Currency (OCC) as of January 1998. The bank was awarded an overall rating of 'needs to improve'.

It received 'low satisfactory' ratings on the lending and service tests, and 'needs to improve' on the investment test. In more detail, its performance was judged poor for responsiveness to the credit needs of the assessed area (investment), for product innovation (lending) and for the level of its qualified investment (investment). But it was rated good for the level of its community lending (lending) and for the distribution of its business loans to businesses of different sizes (lending). The delivery systems in the service test (i.e. branches and cash machines) were found 'relatively accessible' to those in the bank's assessed area.

---

[15] See initially www.federalreserve.gov/DCCA/CRA/

The bank had moved one branch during the period. Branch openings are assessed under the service criteria. The CRA report provides the following general assessment of the branch movements:

> [The bank's] record of opening and closing offices is satisfactory. In July 1997, the bank closed and relocated its Westwood branch to Beverly Hills. This relocation did not have an adverse impact on the low- and moderate-income geographies. The bank did not change its assessment area and both of the communities involved are predominantly middle- and upper-income geographies.

The bank also had plans to close down one branch and open another one in a different location. That closure is commented on in the report, but does not seem to have been assessed, presumably because it had not yet taken place. Since the planned closure involves a branch in a low-income area, with the new branch in an upper income area, one might expect this move to have an adverse effect on the next CRA assessment. The bank's reasons for the planned closure are given, though, and this illustrates how branch closures do need to be explained under the CRA regime:

> The bank recently notified the OCC of its decision to close its downtown Los Angeles Branch and open another branch in Walnut, a suburb 20 miles east of Los Angeles. The downtown branch is located in a low-income census tract. The new branch will be located in an upper-income census tract. The closure and opening are planned for the third quarter of 1998. The primary reasons for closing this office are the long term unprofitability of the Los Angeles branch, and the over-saturation of banks in the immediate area. Additionally, management believes the downtown location is incompatible with the bank's business strategy which is to emphasize commercial real estate lending and trade finance. Management also believes that the bank's growth strategy will be better served by operating in suburban locations.

Christopher Blair