

Remarks by  
Lawrence B. Lindsey  
before the  
Board of Governors of the Federal Reserve System  
Washington, DC  
on the subject of  
Revisions to the Community Reinvestment Act

April 19, 1995

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Thank you, Mr. Chairman. Today, as Chairman of the Committee on Consumer and Community Affairs, I am asking the Board to take action on three related matters: approving a final rule which completely revises Regulation BB -- relating to the Community Reinvestment Act, approving publication for public comment amendments to Regulation B -- relating to the Equal Credit Opportunity Act, and approving a final rule amending Regulation C -- relating to the Home Mortgage Disclosure Act.

Before going further, I would like to extend my heartfelt thanks to two individuals who made this possible: Glenn Loney and Bob Frierson. Their tireless efforts have not only been well beyond the call of duty, but beyond the call of what anyone could reasonably expect of another individual. Somehow, in our many marathon interagency meetings, they managed to keep focussed on the minute details of this regulation long after my eyes glazed over. And, even after expending boundless physical and intellectual energy, they managed to maintain a calm and professional demeanor. The Board is truly fortunate to have such talented individuals on its staff and I shall forever be grateful for their assistance.

The 21 month process of developing a new CRA regulation has raised many complex issues, some involving fundamentally opposing public policy objectives. The final product is unlikely to represent any single individual's or interest group's idea of perfection. But, I believe that we have produced a solid

workable document which meets the objectives the President laid out in July of 1993. So, today I am asking you, my colleagues, for the approval of this regulation not on the grounds that we have produced perfection, but that we have done the best job that could be done.

I would also remind the Board that whatever your hopes or concerns are regarding this regulation, they do not end with whatever action we take today. Before us lie the very difficult tasks of writing examiner guidelines, training our examiners, and actually implementing the rules we are laying out. It is our hope and expectation that these will be done with a maximum amount of interagency cooperation. Whether we meet the objectives we set while avoiding the dangers we fear will be at least as much determined by the actions we take in the future as by the actions we have taken to date. In that regard, there are four continuing issues which have been of ongoing concern and will remain so in the months ahead. I would like to highlight them this morning.

Workability and Sustainability. I have long been on record as believing that CRA can be a cost effective and efficient means of achieving legitimate public policy objectives. In my trips around the country I have seen plenty of evidence that CRA contributes to a process of economic revitalization. However, the reason CRA has worked to date is that it has coupled flexible and workable standards of implementation with an avoidance of extreme requirements that lack a broad base of support among

those who must ultimately carry the burdens of the regulation.

We do no one any favors by promulgating rules which, however well philosophically and theoretically grounded, produce bizarre anomalies when carried out in practice. Similarly, the problems we are dealing with require sustained, consistent, and temperate efforts. A prescription of a period of extreme policy activism followed by the inevitable reaction and resulting period of neglect is the worst thing policymakers could inflict on those individuals and communities in need of revitalization.

I believe that we have avoided these potential pitfalls in this regulation. We have avoided formulaic solutions which might seem an attractive approach to Washington based bureaucracies seeking uniform rules and guidance which do not fit the varieties of experience in the real world. Similarly, we have avoided the extreme requirements sought by some special interests that would ultimately undermine the broad support which CRA needs to fulfill its mission. But, our continued success in avoiding these pitfalls will require continued vigilance.

Regulatory Micromanagement. One of the long standing concerns of this Board regarding CRA has been its potential for regulatory driven credit allocation. At one level it is impossible to deny that CRA has had an effect on the distribution of credit in America. Indeed, if it did not, we would deem it a useless statute. I, for one, have no doubt that more credit is available in traditionally underserved areas than would otherwise be the case as a result of CRA. But that result is not

necessarily bad or economically inefficient. There are reasons to suspect that various market imperfections exist. To the extent that CRA redresses these imperfections without itself creating new distortions, it, on net, contributes to an economically efficient solution. The key is one of balance. I believe that this regulation makes important positive steps in striking the right balance. We make explicit in the regulation itself that CRA programs are not expected to adversely impact the profitability of the bank.

Of more importance, and of continuing issue, is the extent to which this regulation micromanages bank decision making. The strength of CRA is that it instructs us regulators to make sure banks are serving historically underserved communities to the extent it is profitable. The law does not require that a bank serve every community or meet every perceived need.

Our examiners will, under this regulation and with the advent of new technology, have the capacity to micromanage bank decision making to an unprecedented degree. It is my expectation, and those of my colleagues at the other agencies who helped draft this document, that they will avoid this micromanagement. The fact that we have data reported to us down to the census tract level does not mean that loans have to be made in each census tract, or even a cluster of census tracts. Indeed, the cognitive limitations of the human mind should cause any rational mind to rebel at such a detailed level of analysis.

But, the widespread use of computer technology in the

examination process allows the examiner to supersede his or her own mental limitations. And as such, computers should be considered a useful tool. But, as long as individual human minds and not computers are the ones making loan decisions, analysis which searches for patterns so minute that they are not discernable to the unassisted human brain are inappropriately second guessing and micromanaging the lending process. The result is likely to be credit allocation at an economically inefficient level of detail.

While we have avoided any regulatory requirement for this type of micromanagement, it remains a potential threat. Indeed, the expansions of the data collection process in these proposals increases both our potential to use computer based data wisely and to abuse such data. The expansion of HMDA collection in the Regulation C part of today's package, for example, requires that census tracts be labelled on an additional 1.5 million loans, an increase of nearly 40 percent.

Great care must be taken that individual examiners use balance and reasoned judgment, and not just software, in making judgments. Furthermore, we should be clear that the natural tendency of the bureaucratic rule making process is to micromanage, and must be eternally vigilant in resisting such impulses at the policy level.

Public Information. One of the most contentious issues in the CRA process involves the public disclosure of information. Actually, this issue is not unique to this area of bank

regulation. Some commentators suggest that highly detailed reporting of bank's balance sheets would allow the market to make better judgments about safety and soundness, for example. As a society we have resisted such solutions out of a recognition of the value of privacy. Publicly available information can be used for many purposes. It informs competitors, suppliers, and customers. It can be used to refine marketing efforts, develop more sophisticated means of market segmentation and price discrimination, as well as to further the academic study of human behavior in ever greater detail.

Social scientists, which includes most of us at this table have a natural tendency to want ever more information. But we cannot and should not pretend that the public availability of information is an unmitigated good. The efficient functioning of markets requires a good deal of information. It does not require unlimited information, however. In fact, markets would work less well in practice if, for example, the reservation prices of individual buyers or sellers was public knowledge. Confidentiality and privacy are practical requirements of capitalism as well as being cornerstones of liberty.

In response to demands by those seeking ever more information, we have greatly expanded the public availability of information regarding small business lending. With far less data than we are actually making available, any individual could easily tell whether a given bank is making loans in low and moderate income areas of its service area. In addition, market

researchers will be able to make judgments about whether the industry is collectively making an adequate number of loans in each and every one of the 60,000 census tracts in this country. The extent of highly detailed micro-information released to the public as a result of this regulation is more than ample for the conduct of legitimate public policy research.

Frankly, the amount of detailed information which will be available to the public as a result of this regulation probably far exceeds anything ever imagined when CRA was passed. At the risk of being unpopular among my fellow social scientists, I think we have to begin to wonder about the appropriate degree of balance now being struck in the public availability of confidential financial information. As individuals, we have long since lost the fight against Big Brother knowing every detail of our financial lives. The current issue is whether Big Brother can tell what he knows to all the Aunts, Uncles, Cousins, Nieces and Nephews in the land.

Collection of Personal Non-Financial Information. The final issue I would like to turn to in this package involves Board policy regarding the collection of personal non-financial information by financial institutions. It has long been this Board's position that the use of such irrelevant characteristics as race, gender, religion, and national origin has no place in decisions regarding the provision of credit. Not only is the use of such factors abhorrent to our sense of democratic decency, it also undermines the functioning of the market and therefore the

underpinnings of capitalism. As believers in democratic capitalism we are therefore extremely perturbed about race conscious and gender conscious practices.

After the passage of the Equal Credit Opportunity Act, the Board adopted a policy that could be termed Don't Ask, Don't Tell with regard to such information. It was the Board's view that such information could only be misused. Although widely accepted at the time, this view increasingly became, until recently, a minority one in official Washington circles. On the other hand, recent intellectual trends may be suggesting that the Board was really just ahead of its time. For those with any doubt about the efficacy of our past behavior, I would refer you to this week's issue of the Economist.

But, as I mentioned, our Don't Ask, Don't Tell policy is not as widely accepted as it once was. Amendments to HMDA, for example, created a policy which I would term, "ASK, and if they don't tell, write something down anyway". As a result, banks now face a hodge-podge of approaches to this very sensitive issue. At the very least this is confusing. It may also be hampering some well intentioned activities by financial institutions. Some institutions, unsure of their present managerial controls, may want to collect such information for monitoring the behavior of their own lending apparatus. Other institutions may want to seek agreements with community groups which target specific numbers of loans to specific groups. I am familiar with at least one instance of this. While such privately contracted race-based set

asides may face constitutional questions, they are essentially impossible to attempt under the current Regulation B policy.

What the Board will be doing by adopting this proposal is adopting an essentially libertarian view: "Ask if you want, tell if you want." Banks will be under no obligation to ask for these irrelevant criteria, individual customers, even if asked, will be under no obligation to tell. However well intended our original proscription on such behavior may have been, the social, political, and philosophical complications which have surrounded this issue suggest that we may be getting into an area of controversy in which we are not expert. The proposed approach allows the Board to defer to the Congress and the Courts regarding an issue more appropriately left to their domain.

Again, much of the challenge of CRA lies ahead of us. Successful implementation will require us to be eternally vigilant about the potential pitfalls I have discussed. But, given the quality of the work done to date, I have every confidence that we will be satisfied with our final product. Glenn Loney will now discuss some of the details of the plan and both of us will be happy to answer your questions.