

Economic Commentary

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The Community Reinvestment Act: Early Experience and Problems

by Thomas M. Buynak

The Community Reinvestment Act of 1977 (CRA), effective November 6, 1978, requires financial institutions to "... demonstrate that their deposit facilities serve the convenience and needs of the communities in which they are chartered to do business." The CRA directs four regulatory agencies—the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Federal Home Loan Bank Board (FHLBB), and the Federal Deposit Insurance Corporation (FDIC)—to encourage each institution under their jurisdiction to help meet the credit needs of the local community. The four regulatory agencies also are required to assess an institution's record of meeting the credit needs of its community, including low-to-moderate income neighborhoods, consistent with the safe and sound operation of the institution. These assessments are to be taken into account when the regulatory agencies evaluate various applications by institutions.¹

1. Community Reinvestment, Regulation BB, Board of Governors of the Federal Reserve System, Sec. 228.2—Purposes. For a review of the regulations, see Thomas M. Buynak, "The Community Reinvestment Act," *Economic Commentary*, Federal Reserve Bank of Cleveland, December 26, 1978.

This *Economic Commentary* examines the experience and responses of the individuals, institutions, and agencies that have worked with the CRA during the past 30 months. These include the community groups that have filed CRA protests challenging the expansion plans of financial institutions; the regulatory agencies that have issued various guidelines and policy statements to implement the act; and the financial institutions that have responded to the CRA by expanding their activities relating to community interaction and development. This *Economic Commentary* also questions whether the act has been effective and details the issues and factors that may influence the role of financial institutions in community reinvestment.

Protests Lodged

The CRA offers the public an opportunity to challenge the expansion plans of financial institutions that are considered to

Thomas Buynak is an economic analyst, Federal Reserve Bank of Cleveland.

The views stated herein are those of the author and not necessarily those of the Federal Reserve Bank of Cleveland or of the Board of Governors of the Federal Reserve System.

be unresponsive to the credit needs of the community. Nationwide, approximately 100 protests have been filed against the applications of financial institutions on CRA grounds; most of these have been lodged by community organizations. Although the protests have been widespread, the majority have occurred in Boston, New York City, Philadelphia, Cleveland, Toledo, Detroit, St. Louis, San Francisco, and Los Angeles.

Community groups were somewhat hampered in their initial efforts to utilize the CRA by their unfamiliarity with the operations of regulatory and financial institutions. Following this period of uncertainty, various strategies were developed by community groups to use the act more effectively. A major outgrowth of these campaigns has been the filing of well-documented protests. Such protests have given community groups leverage in seeking CRA concessions from financial institutions.

Protesting groups seem to have little complaint regarding the technical requirements of the act. A financial institution is required to adopt a CRA statement, maintain public CRA files, and display a CRA notice in its offices. The CRA statement must include a delineation of the area that comprises the institution's community; a list of the principal types of credit that the institution is prepared to extend; and a copy of the CRA notice displayed in its offices. The public CRA files must, among other things, contain any signed comments received from the public on the financial institution's record of serving the credit needs of its community. The CRA notice includes information on the availability of the institution's CRA statement. Some community groups have been critical of the lack of initiative of financial institutions to incorporate unrequired, but suggested, items into their CRA statements. Institutions have been encouraged, for example, to incorporate into their CRA statements a description of their marketing programs on the availability of credit services.

One issue that consistently has been raised in the protests is the failure of financial institutions to serve adequately the housing-related credit needs of low-to-

moderate-income, minority, and transitional (i.e., racially integrating) neighborhoods. This allegation essentially reasserts concern over the longstanding, yet controversial, issue of redlining—the alleged practice of institutions of systematically refusing, or severely limiting, credit to certain urban neighborhoods because of the location or age of the property without regard to the credit worthiness of the applicant or concern for the condition of the property. To document this assertion, community groups have relied on data supplied by financial institutions under the Home Mortgage Disclosure Act (HMDA). These data, coupled in some cases with census information on housing, income, and population, have been used to analyze the lending patterns of institutions across various neighborhoods.

Protestants have registered many other complaints. These include a failure of institutions to advertise the availability of housing-related credit in low-to-moderate-income neighborhoods; a low level of involvement in the Small Business Association (SBA) loan program; excessively restrictive mortgage loan policies, such as high down-payment requirements vis-à-vis other institutions in the community; the pre-screening of potential loan applicants; and inadequate efforts to ascertain community credit needs.

Regulatory Response

Implementing the CRA has been more difficult than anticipated. Unlike previously enacted consumer legislation affecting financial institutions, regulatory agencies were charged not only with implementing and enforcing the CRA but also with defining it. The CRA lacks specific direction and reflects the congressional ambivalence existing during its passage over the extent to which government should become involved in supervising the lending decisions of private financial institutions. Consequently, implementation has been slowed by the lack of guidance from Congress as to what the scope and impact of the CRA should be.

Regulatory agencies discharge a number of functions under the CRA. The agencies assess each institution's record of perfor-

mance in helping to meet community credit needs. These assessments are taken into consideration when the agencies evaluate an institution's application for a charter, branch, office relocation, deposit insurance, merger, or acquisition. The agencies in fact may deny an institution's application if it is judged not to comply with the substantive provisions of the CRA. Furthermore, since the CRA extends an opportunity to the public to challenge a financial institution's application, the agencies must evaluate the merits of CRA objections and take those found to be meritorious into account when considering an institution's application.

The CRA assessment or examination consists of two parts—a review of technical compliance and an evaluation of an institution's performance in serving the credit needs of its community. The assessment of an institution's CRA performance focuses on several factors enumerated in the regulations; these items have been incorporated

into uniform examination procedures that were issued shortly after the CRA was implemented (see box). A uniform rating system also has been issued for consistent interpretation of ratings assigned to various performance levels. Although this uniform rating system exists, the CRA assessment differs in an important respect from the other parts of the consumer examination. Specifically, in formulating the examination procedures, the agencies did not assign explicit weights to, nor design an explicit scoring system for, the assessment factors. It was believed that such weighting or scoring would limit an institution's responses to local credit needs. A significant aspect of the CRA examination thus is the overall interpretation assigned to each of these assessment factors.

Four applications have been denied on CRA grounds to date. Three denials were by the FDIC, two involving branch applications and one a merger. All three FDIC cases were protested by local community organizations. The fourth denial was issued by the Comptroller of the Currency and was decided despite the lack of a CRA protest. Of the four denials, three since have been approved after steps were undertaken by the institutions to improve their CRA performance. As an example, in reconsidering the branch application of the Dauphin Deposit Bank and Trust Company of Harrisburg, Pennsylvania, the FDIC stated that "... significant and substantial negotiations have taken place between the applicant and the protestants, the results of which constitute, in part, the 'marked improvement' called for." As embodied in the written agreement between applicant and protestants, the bank had, among other things, agreed to hire a full-time community relations specialist; improve its marketing and advertising programs; institute procedures to review loan denials originating in low-to-moderate-income neighborhoods; and commit specific funds for mortgage and home improvement loans over the next three years in the city's low-to-moderate-income neighborhoods.

While the regulatory agencies have issued only four denials, they have incorporated

CRA Assessment Factors^a

The following list comprises a few of the factors that regulators consider in a CRA assessment:

- Activities undertaken by an institution to ascertain community credit needs, including the extent of efforts to make its community aware of available credit services;
- An institution's origination or purchase of loans for residential mortgages, housing rehabilitation, home improvements, and small farms within its community;
- The geographic distribution of an institution's credit extensions, applications, and denials;
- Any evidence of prohibited discriminatory or other illegal credit practices.

a. See Community Reinvestment, Regulation BB, Board of Governors of the Federal Reserve System, Sec. 228.7—Assessing the Record of Performance, pp. 5-6.

conditions or commitments into approvals in many cases where institutions have exhibited questionable CRA performance.² Most conditional approvals, moreover, have involved applications against which a protest was filed. The agencies also have required CRA adjustments of institutions as a result of their own examination process. For example, roughly one-half of the FDIC's commitments and conditions have been imposed as a direct result of the examination process without protests or an application pending by the institution.

The CRA adjustments required by the agencies have varied, but the most common is a commitment to increase efforts to communicate with the institution's community and to improve community awareness of the institution's credit services. Some of the other commitments or conditions imposed include designating a CRA officer; upgrading the institution's commitment to extend mortgage credit throughout its entire community; improving the training programs for lending personnel; making publicly available the institution's real-estate appraisal standards; and participating in special lending programs.

Since the agencies are required to evaluate and take into account CRA claims filed by the public when deciding upon an application, they have issued a number of guidelines and policy statements to inform and involve the public in the application process. The Federal Reserve System, for example, has issued information on the requirements of the act and procedures for applications and protests. In addition, the agencies have implemented a system for sharing and exchanging CRA information, such as consumer examination reports, as part of their efforts to coordinate enforcement.

It is the explicit policy of the agencies to encourage discussion between applicants and protestants to help resolve their differences. In many cases, such resolution has resulted in commitments by financial insti-

tutions. The agencies generally have shown a balance between past and future performance. Moreover, they have stressed that they will assess not only the significance of any commitments, but also the likelihood of future improvement in CRA performance of financial institutions.

Response of Financial Institutions

The CRA has been a controversial piece of legislation since its beginning. While community groups allege that redlining is a widespread practice, financial institutions assert that they are meeting neighborhood credit needs in a manner consistent with prudent lending practices. Prior to passage of the CRA, much of the financial community's opposition warned that the act's passage would represent a major move in the direction of nonmarket credit allocations. These concerns still exist, even though the regulatory agencies have stressed repeatedly that the act does not represent a regulatory scheme in which financial institutions are required to allocate credit. The Federal Reserve Board has explicitly stated:³

Although CRA is directed at the problem of meeting sound community credit needs, it was not intended to establish a regulatory influence on the allocation of credit. In implementing the Act, the Board has acted on the belief that banks are in the best position to assess the credit needs of their own local communities

The Board has further indicated that it will not endorse any agreements to allocate credit. In this connection, the Board has indicated that:⁴

[It] is aware that many banks have on their own initiative adopted special pur-

2. The distinction between commitments and conditions hinges primarily on the fact that without a condition, an application otherwise would be denied.

3. Federal Reserve System, Community Reinvestment Act, Information Statement, January 3, 1980, p.1.

4. Federal Reserve System, Community Reinvestment Act, Information Statement, January 3, 1980, p.3.

pose credit programs, or pilot programs to test new credit offerings. The Board does not wish to discourage these efforts. However, the Board will closely scrutinize any agreements to ascertain that they are not inconsistent with the safety and soundness of the bank involved, and do not establish a preference for credit extensions inconsistent with evenhanded treatment of borrowers. . . .

The response by financial institutions to the CRA generally has been favorable. An overwhelming number of institutions have become much more actively involved in meeting with community groups, as well as with other segments of their community. In response to the CRA protests, a pattern has emerged in which financial institutions are agreeing to undertake adjustments in their CRA performance. As previously seen, these adjustments, mostly in the form of commitments, demonstrate a willingness to work with the agencies and community residents to implement the act. A number of institutions have voluntarily entered into settlement agreements with community organizations. Other responses by institutions also are beginning to emerge. Some financial institutions have begun to assume a new posture in community development by undertaking projects or programs in which financial risks can be shared. Such coordinated pooling of resources has permitted institutions to undertake investments that formerly were considered to be less viable. An example of such efforts can be seen in Springfield, Massachusetts, where 11 local commercial and savings banks and two insurance companies recently re-channeled their development efforts to revitalize the downtown Springfield area. The institutions formed a consortium and established three loan pools: a \$16-million mortgage pool to finance downtown development projects ineligible for conventional financing; a \$10-million pool for the acquisition and rehabilitation of a department store; and an \$11-million pool to attract high-technology businesses into the downtown area. These loan pools have proven to be a catalyst in

attracting a new flow of private investment into downtown Springfield.⁵

Has CRA Been Effective?

The CRA encourages financial institutions to help meet the credit needs of their communities, including those of low-to-moderate-income neighborhoods. Whether accomplishment of this objective merely requires more effective identification of community credit needs, or whether it will necessitate more systematic efforts, has yet to be determined. However, a framework is evolving to ascertain the proper role of financial institutions in serving the credit needs of their entire communities. In particular, institutions have demonstrated a willingness to increase efforts to ascertain community credit needs, as well as to make the public more aware of the availability of credit services. These measures appear to be prerequisites to serving community credit needs and, in the future, may affect a financial institution's lending or other CRA-related activities.

Some concern has arisen that the enforcement of the CRA, and other consumer banking regulations as well, may in fact be counterproductive and further reduce the supply of credit in central-city neighborhoods. In a recent study prepared for the FHLBB, Guttentag and Wachter found that the regulations may help shift housing-related credit in the desired direction, but only in the short run.⁶ Enforcement of the

5. For more detailed information regarding these efforts, as well as a survey of some other development projects, see "Investing in the Future of America's Cities: The Banker's Role," *Six Case Studies*, prepared by the National Council on Urban Economic Development for the Office of the Comptroller of the Currency, Community Development Division.

6. See Jack M. Guttentag and Susan M. Wachter, "Redlining and Public Policy," *Monograph Series on Finance and Economics*, New York University, 1980-1. For an abbreviated article by the same authors on this study, see "How to Erase Redlining," *Wharton Magazine*, vol. 5, no. 1 (Fall 1980), pp. 13-21.

regulations will exacerbate the problem of urban blight because the higher costs of the regulations eventually will reduce the supply of housing-related credit. Less credit will be available, and it will be more expensive, which may disproportionately affect precisely those individuals the regulations were intended to benefit.

Conclusion

Overall, the response that has emerged to the CRA has been encouraging. A pattern of compromise between financial institutions and community groups has begun to emerge. With the encouragement of the regulatory agencies, there appears to be an increased recognition that the CRA represents an opportunity to re-examine the degree to which financial institutions can prudently help serve community credit needs.

Many of the initial implementation problems have been corrected. The regulatory agencies have become more skilled and knowledgeable in addressing CRA issues, permitting CRA-related problems to be

handled more efficiently.

A number of issues obviously remain to be resolved. One area of major concern is the interpretation of the various components of a CRA assessment. For example, should an institution's CRA performance be compared with the experiences of other institutions, or should some minimum standards be used to evaluate the institution's performance? How should an institution's strong performance under some of the assessment factors be weighed against weak performance under others? Another area of key concern is the protest process. Although much has been accomplished to expedite the handling of CRA protests, a significant amount of time and resources is still required to process some protests. The agencies will have to continue to monitor and evaluate the cost of additional analysis of protest issues against the benefits resulting from having more extensive information. It will be the task of the regulators to examine these and other issues, balancing the objectives of solvency and profitability with that of responsibility toward the community.

Federal Reserve Bank of Cleveland
Research Department
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