

FRBC Community Reinvestment Forum

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Jordan Speech

I. Why Do We Have CRA?

A. Banks have a federal subsidy, in the form of taxpayer-backed deposit insurance.

1. Regulations/restrictions have been put in place to keep banks safe in order to protect the deposit insurance fund.
2. Congress has also found that it can mandate social change through banks because banks have this federal subsidy.
3. CRA is one of the mandates imposed on banks by the Congress.

B. Logic behind CRA

1. Bankers are in business to make loans, including mortgage loans.
2. Mortgage loans are not being made to minorities in some communities because:
 - a. Unfortunately, it is falsely asserted or assumed that bankers are racist and are willing to forego known profitable opportunities as "price for engaging in racial discrimination."
 - b. Or, information about credit-worthiness of potential lending opportunities to minorities is costly and/or inaccurate.
3. In theory, racists could simply absorb the losses created by their own discrimination.
4. But in reality, it is very difficult to find evidence of people who are willing to forego profits in order to discriminate.

C. Data are inconclusive on whether lending patterns are driven by racial prejudice or economic factors such as credit history of potential borrowers.

1. Data and statistical analysis can quantify loans made, or not made, in certain communities.
2. Low levels of bank lending to low-income areas may arise, in part, due to a lack of information about opportunities or erroneous information about the associated risks.
3. Data cannot eliminate lending bias if it exists; lending bias can only be eliminated on an individual basis by the loan officer and the applicant.

D. High costs of gathering information may have kept banks from voluntarily seeking credit-worthy borrowers.

1. The current mandated approach could backfire if costs become too high for the bank.
2. Adopting a "numbers-oriented" approach could end up being cost-prohibitive and may result in banks pulling out of an area altogether and to redefine its market.
3. If CRA compliance and reporting costs are prohibitive, and barriers to exit a particular neighborhood are high, may simply put banks at a competitive disadvantage with other financial services institutions that do not have CRA responsibilities.

II. Banking Business--Information, Risk, and Lending

A. Commercial banks primary function is intermediation.

1. Banks have a comparative advantage in evaluating credit and monitoring loans-rely on information.
2. To the extent that banks are expert and efficient in the intermediation process (handling risks) determines their market share.

B. A lack of information can affect the credit allocation across segments and within segments.

1. A tradeoff exists between the costs associated with gathering more and better information and reducing the risk of default.
2. Costs in some regions or areas may vary sharply for an institution and thus it may be extremely costly to lend in a particular area.
 - a. With few branches and/or loan officers in the area, it may be costly to identify new, profitable lending opportunities.
 - b. Therefore, the expected returns on lending in areas where the bank has little or no presence are likely to be much lower than elsewhere, making it highly unlikely that the bank will increase lending in these areas.
3. If racial or ethnic characteristics are associated with these high cost areas, bank lending patterns may appear to be correlated with such characteristics.
 - a. May give rise to perception that banks discriminate.
 - b. And the perception that banks are not interested in serving the needs of community.
4. Our community affairs objective is to lower the costs of information to both the borrower and the lender.
5. This involves changing perceptions about opportunities and risks.
6. Meeting this challenge is important, especially at a time when Congress considers extending the scope of CRA to small business lending.

III. Ongoing Debate On What CRA Is and What It Requires from Banks.

A. Narrow interpretation:

1. CRA is anti-redlining, therefore, regulators are charged with identifying redlining.
2. However, evidence in redlining studies is inconclusive.

B. Broad interpretation:

1. CRA is a mechanism to ensure equal credit access to low and moderate income neighborhoods **regardless of redlining**.
2. Legislative mandate is that financial institutions search for good loans in disadvantaged neighborhoods but does not outlaw the rationing of credit or require banks to make riskier loans.
3. The law imposes on banks and thrifts the costs of seeking out borrowers in areas that are perceived to be more risky.
4. Noncompliance penalties are imposed if the financial institutions demonstrates insufficient efforts to provide equal access to credit in the community.

C. Making Credit Available to minorities is an issue that Congress views as being very important and bankers are responding.

D. For the vast majority of bankers, the social objectives of CRA are not objectionable; rather, it has been the sometimes heavy compliance and reporting requirements that have generated so much antagonism.

IV. The Banking Environment of the Past

A. Focus was on loan volume.

1. In the '70s and '80s, largely spurred by inflation, incentives were geared toward large loan volume.
2. Culture of that period was to book large loans and move on to next job before the loans went sour.
3. This culture discouraged hard-to-do inner city loans.

B. In the '70s and '80s, S&Ls dominated the home mortgage industry, and banks did not develop an expertise in mortgage lending.

C. Mortgage lending criterion has become cookie-cutter in order to sell mortgages in secondary markets.

V. Today's Banking Environment

A. Today's banking environment has changed.

1. S&L industry has shrunk.
2. Banks are now competing with nonbanks even in the mortgage lending business.
3. Nonbanks are not covered by CRA, and they do not take the time to develop relationships in minority communities.

B. In today's environment, banks are seeking earning assets.

1. Perception that there is a lack of loan demand.
2. Yet, there is no lack of loan demand for new and better housing, especially among low- and moderate-income groups.

C. In today's competitive environment, bankers have to be more customer oriented.

1. Regulated industries tend to forget how to be responsive to customers.
2. Bankers need to develop the same relationships with small customers as they had with large corporate customers.
3. Bankers have to be more flexible with lending criterion--does not mean make bad loans.
4. The key to solving our lending problems lies in good old fashioned business sense about how to run a service business.
 - a. Responding to the customer is key.
 - b. Loan officers must extend the same courtesy and the same coaching to all customers of all races.

VI. CRA Can Reduce Transactions Cost and Provide New Business Opportunities.

A. CRA can be used to improve information flows so that markets can work more efficiently and banks can find profitable opportunities.

1. Among borrowers in low-income areas there is a lack of knowledge about credit and the credit process.
2. Among lenders there is widespread lack of recognition of the size and potential value of minority lending.

B. CRA programs can increase knowledge about markets and consumer needs.

1. CRA Programs can add to the effectiveness of lending policies and procedures, thereby raising the return on loan portfolio.
2. Information may be brought to bear for future programs.

C. Involving others, through outreach programs, can lower transaction costs and generate new business relationships.

1. Some of the banks in the Fourth District have started lending programs which work through churches in minority neighborhoods.
 - a. The programs include classes on how to apply for a loan and also provide credit counseling for those with poor credit histories.
 - b. In addition, the ministers serve as liaisons for the banks, explaining the banks products to their members and providing valuable information to banks about their members.
2. These programs are ways of gathering more information in order to make informed judgements on loan applications; this is much different, and more effective, than the simple data gathering approach required by HMDA.

VII. Free markets and discrimination.

- A. The marketplace puts a price on incorrect generalizations, as it does on all sorts of other incorrect assumptions.**
- B. Successful CRA programs are not a result of political pressures, but because banks have gained additional knowledge--transactions costs have been lowered.**
- C. Banks with successful CRA programs view CRA as a business opportunity.**
 1. Incorporate CRA into their strategic plan.
 2. Adopt incentive systems to reward lending officers who make loans in low-income area, not just reward lending officers based on volume.
 3. Involves finding out what the customer needs (all customers), designing products which will meet those needs, selling those products, and monitoring the success of those products.
- D. Banks that view CRA as a burden will find it difficult to develop a successful (profitable) program.**
- E. By now we should have learned that you cannot legislate success.**

VIII. Role of the Federal Reserve

- A. The banking industry is in transition. It has been a protected/regulated industry that must become more demand driven and customer oriented.**
- B. The Federal Reserve Act mandates that we maintain "safety and soundness" of the banking system as one of the necessary conditions for achieving maximum sustainable growth of our standard of living.**

C. To the extent that there is a perception of CRA being too risky and costly, we must find ways to overcome these perceptions.

1. CRA is not unlimited access, it is qualified access
2. CRA does not involve below market financing with high credit risk
3. CRA is consistent with safety and soundness.

D. Community Affairs Office--aid market discipline

1. Facilitate information and educate.
2. Prepare consistent and understandable evaluations.