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I am Ellen Harnick, Senior Policy Counsel at the Center for Responsible Lending (CRL), a nonprofit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, a nonprofit community development financial institution that consists of a federal and a state credit union and a non-profit loan fund.

For close to thirty years, Self-Help has focused on creating ownership and economic opportunity for low wealth families, people of color, women and rural residents by making responsible home loans and small business loans to people who might not otherwise have access to affordable credit. Self-Help's lending record includes a secondary market program that enables private sector lenders to make responsible home loans to low- and moderate-income borrowers. In total, Self-Help has provided over $5.65 billion of financing to 64,000 low-wealth families, small businesses and nonprofit organizations in North Carolina and across America.

I appreciate the opportunity to speak to you today about modernizing the regulations implementing the Community Reinvestment Act ("CRA") to keep up with the substantial changes that have taken place in the banking sector in the three decades since the Act was enacted. These regulatory reforms are necessary to accomplish CRA's objective of ensuring that financial institutions meet the banking needs of the communities they are chartered to serve.

Depository institutions receive valuable public benefits, including federal deposit insurance and access to favorably priced borrowing through the Federal Reserve's discount window. The duty to meet the banking needs of all segments of the communities banks are chartered to serve is rightly seen as a *quid pro quo* for these substantial benefits.

It is painful to watch the effects of predatory lending and the recent recession strip away the savings and equity that low- and moderate-income families and communities have spent years working so hard to build. Reasonable efforts now to modernize CRA to meet the banking needs of these communities can play a significant role in stemming the tide of neighborhood decline, and putting underserved communities back on the road to financial stability.

As detailed below, we urge the following specific regulatory improvements:

1. Broaden CRA assessment areas to reflect the actual scope of bank activity. In any state where an institution has at least $10 million in deposits or loans, the institution's CRA compliance should include low- and moderate-income neighborhoods in that state.

2. Require that the activities of affiliates—both good and bad—count toward the CRA rating of the related institution to the same extent as the institution's own activities.

3. Specifically incent fair and affordable savings and transactions services specifically targeted to meet the needs of low- and moderate-income individuals, including the unbanked and under-banked. CRA credit should apply only for those savings and transaction accounts that are low-fee, impose no high-cost overdraft fees, require no more than nominal-minimum deposits, and are accessible at hours and locations suitable to unbanked and under-banked customers.

4. Strengthen incentives for fair and affordable small dollar consumer loans for low- and moderate-income individuals.

5. Strengthen incentives for fair and affordable small business loans for low- and moderate-income individuals.

6. Incent sustainable mortgage loan modifications for low- and moderate-income individuals and communities that reduce principal balances to, or near, the current value of the mortgaged property and reduce interest rates sufficiently to render the loan affordable at the borrower's current income.

7. More effectively incent loans and investments for community development projects—not as a substitute for, but in addition to, direct service to low- and moderate-income individuals. All institutions, regardless of size, should be evaluated on their community development loans and investments. The institution's size and capacity should be taken into account in determining appropriate standards for community development loans and investments.

8. Make the CRA ratings system more meaningful by ensuring a transparent, public evaluation that reflects significant differences in bank performance. Implement economic incentives, including benefits for outstanding CRA performance, and penalties (such as fines, payable to benefit the relevant communities) for less than satisfactory performance. The benefits for outstanding performance should *not*, as some institutions have urged, include less frequent CRA examination.

9. Revise CRA examinations to scrutinize lending, investing, and service to minorities and communities of color, to ensure that institutions serve all segments of the communities they are chartered to serve.

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A. Introduction: Community Reinvestment and the Current Banking Environment

Depository institutions receive valuable public privileges. In return, they are appropriately required to meet the needs of all segments of the communities they are chartered to serve.

Banks and thrifts enjoy important public privileges, including federal deposit insurance and low-cost borrowing from the Federal Reserve's discount window.[1] In return, CRA imposes the affirmative obligation that they meet the needs of all segments of the communities they serve, including low- and moderate-income neighborhoods.

This obligation is grounded in the fundamental role that banks and banking services play in modern economic life. Without a bank account, it is difficult to safely accumulate savings or manage household finances. Bank accounts also facilitate basic day-to-day transactions such as converting checks to cash, paying bills, transmitting funds securely, and meeting household liquidity needs. Households lacking reasonably-priced means of accomplishing these functions have little realistic ability to pursue economic opportunity, or save for the future.

Low- and moderate-income communities and communities of color continue to be disproportionately underserved by mainstream financial institutions, as they were when the CRA was enacted. Fully 54% of African American households and 43% of Hispanic households are unbanked or under-banked today, meaning they rely on alternative financial service providers such as check-cashers and payday lenders for some or all of their banking needs.[2] These families are forced to divert significant portions of their income each year to obtaining high-cost banking services from non-bank providers.

With respect to home mortgage lending, communities of color have been disproportionately underserved by mainstream financial institutions, and disproportionately targeted by non-bank subprime mortgage lenders who provided them with higher-cost, less sustainable loans than they qualified for.[3] Typically, these homeowners paid more for their loans than comparably qualified white homeowners, further eroding their economic foundation.[4] Studies have repeatedly shown that race has an independent effect on the likelihood of obtaining a higher priced mortgage loan.[5]

Highly explosive subprime loans were marketed aggressively in underserved communities and have contributed to a disproportionate number of foreclosures in low- and moderate-income neighborhoods. It is unfortunate that more borrowers did not instead receive affordable, sustainable CRA qualifying loans, in part because depository institutions were not sufficiently working in these neighborhoods to market and promote their products. Studies have shown that CRA-covered loans had better terms, and significantly lower foreclosure rates, than loans made to similar borrowers by the non-bank lenders who made the majority of abusive subprime loans.[6] The spillover effects have meant that even borrowers who avoided such loans still are at a higher risk of foreclosure.[7]

Unfortunately, America's most vulnerable homeowners were disproportionately targeted by irresponsible non-bank lenders, and were underserved by mainstream banks. When these homeowners did obtain loans from mainstream depository institutions, they were better served when the loans were made within the institutions' CRA "assessment areas" than outside those areas. Studies have shown that loans made by institutions within their CRA assessment areas were less likely to be "higher-cost" than those made outside of CRA assessment areas,[8] and significantly less likely to be in foreclosure than loans made outside of CRA assessment areas.[9]

In the fall of 2008, America's taxpayers were called upon to rescue the large mainstream banks from their massive investment in abusive subprime mortgages, revealing the enormous extent of these institutions' financial involvement in lending activities that destroyed low- and moderate-income communities.[10] In the aftermath of these devastating activities, it is even more critical that responsible mainstream institutions fulfill their obligation to provide stable and affordable financial services to the communities in which they do business. Such investment will facilitate the rebuilding of low- and moderate-income neighborhoods and contribute to overall economic stability. With modernized regulations, CRA can play a critical role in meeting this need, stimulating economic recovery where it is needed most.

CRA must be adapted to technological and market changes.

The thirty years since CRA's enactment have seen major technological and market changes, but CRA regulations have not kept up with these developments. Banking today is a global activity, rendering inadequate CRA's focus on institutions' service to neighborhoods surrounding physical branch locations. Such focus overlooks many essential activities of institutions that operate nationwide and take deposits and make loans over the internet and telephone. Almost 60% of large bank lending today occurs outside these institutions' assessment areas.[11]

Regulatory changes have been similarly dramatic. Banking laws now permit institutions to acquire non-bank affiliates and conduct business through them. Yet institutions have the option of choosing whether regulators consider the actions of these affiliates in evaluating the institutions' CRA compliance. In 2005 and 2006, at the height of the subprime lending spree, 12%-13% of "higher-cost" loans were made by affiliates of CRA-covered institutions.[12] Many of these affiliates engaged in predatory mortgage lending that stripped substantial wealth from low- and moderate-income communities and communities of color, yet were fully shielded from CRA review.

Nor does the CRA rating system adequately incent financial institutions to fulfill their CRA obligations. Regulatory grade inflation for CRA assessments has resulted in the vast majority of institutions receiving "satisfactory" ratings for their CRA performance, notwithstanding the under-service many communities receive. And there are neither sufficient consequences for less than satisfactory ratings, nor significant inducements to strive for outstanding ratings, which severely undermines incentives for institutions to better meet their CRA obligations.

Depository institutions must do a better job of meeting the needs of low- and moderate-income communities throughout the states where these institutions do significant business. This means offering simple, low-cost bank accounts (including savings accounts), with no or nominal minimum balance requirements, with no high-cost overdraft programs, and with low-cost checking and transactional services that are easily accessed after business hours, after many low- and moderate-income wage earners return from work. It also means offering fair and affordable credit, not only for home mortgage loans, but small dollar loans and loans for small businesses. And it means modifying foreclosure-bound mortgages where reducing principal and interest rates can render the loan sustainable for the homeowner.

CRA regulations also should do more to support the one type of financial institution that has been serving low- moderate-income communities and communities of color assiduously: community development financial institutions (CDFIs). These institutions will never have sufficient resources to perform the role that mainstream depository institutions must play, but they are an essential part of any effort to meet the needs of underserved communities. The banking agencies should better incent CRA-covered institutions to support CDFIs with investments and loans.

The crisis among non-CRA subprime mortgages, and the contrasting success of CRA loans, demonstrates the value of CRA lending.

CRA lending was one of the few bright spots in a period marked by predatory and irresponsible lending to low- and moderate-income communities. In contrast to the high default and foreclosure rates on subprime mortgage loans, the majority of CRA-covered institutions report that their CRA Special Lending programs were either profitable or break-even.[13] Similarly, a report issued by the Federal Reserve Board in 2000 concluded that mortgage loans satisfying the low- and moderate-income element of the CRA's lending test proved to be at least marginally profitable for most institutions, and that many institutions found that CRA lending performed no differently than other lending.[14]

The experience of community development financial institutions likewise demonstrates that responsible lending to low- and moderate-income people is consistent with safe and sound lending practices. A recent report on the FY 2007 performance of CDFI banks, found that the majority were profitable. These institutions operate over 71% of their branches in low- to moderate-income communities. Similarly, community development credit unions had a loan loss rate that was on par with that of mainstream credit unions.[15] These data highlight the effectiveness of responsible, sustainable lending to low- and moderate-income communities.

While some critics have sought to blame CRA for the subprime crisis, rather than subprime lenders and their Wall Street and large bank investors, such claims turn reality on its head. Fully 94% of subprime mortgage loans were made by institutions not covered by CRA, including affiliates that were excluded from CRA compliance review.[16] Contrary to the critics' claims, the subprime foreclosure epidemic was the result of predatory loans made to people who were *shut out of, or steered away from*, the mainstream financial institutions covered by CRA. For this reason, OCC Chairman John Dugan, and most impartial analysts, reject such claims.[17]

With better CRA regulations, and more effective enforcement, the banking agencies can fulfill the promise of CRA, making responsible banking services and economic opportunity more fully and fairly available to all communities.

B. Specific Problems and Proposed Solutions

Over the past thirty years, changes in technology, regulatory environment and market practices have altered the way banking services are delivered. CRA regulation must evolve with these changes to remain relevant. Discussed below are the major problems that have emerged with respect to CRA compliance, along with our proposed solutions.

1. Assessment areas do not accurately reflect the scope of institutions' activities, and are no longer an appropriate basis for measuring CRA compliance.

CRA requires the federal banking agencies, when examining a financial institution, to assess such institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operations. The regulations require the agencies to assess CRA performance based on "assessment areas" which must "[i]nclude the geographies in which the bank has its main office, its branches, and its deposit-taking ATMs, as well as the surrounding geographies in which the bank has originated or purchased a substantial portion of its loans."[18]

The geographic scope of bank operations has expanded substantially since 1977. This is largely a consequence of the Riegle-Neal Interstate Banking and Branching Act of 1994, which eliminated most restrictions on interstate bank acquisitions and expanded banks' ability to operate in multiple states. The banking industry has shifted away from local institutions serving communities in a single location, to a market in which most of the top institutions operate nationwide in multiple locations. For example, in 1977, most federally-insured commercial banks and credit unions (54%) had just a single location, with no branches at all. There were no nationwide depository institutions. By 2007, the proportion of single location institutions was down to 24%, and most of the top 25 institutions were operating nationwide, taking deposits and making loans in markets across the United States.[19]

Technological advances have further revolutionized banking in a way that has expanded institutions' geographic reach. Institutions now provide transaction, credit and savings services over the internet and telephone to customers across the country, far from the institutions' physical branch locations. Assessment areas are no longer where most depository home mortgage loans are made. Large banks today make only 40% of their

HMDA loans in their assessment areas (2007 data), down from over 70% in 1990.[20] The banking industry is also much more concentrated than it was thirty years ago. Thus, the largest institutions now claim a larger share of all banking deposits, and hold a larger share of consumer loans than was the case in 1977.[21] And even small banks now make close to one-third of their HMDA loans outside of their assessment areas.[22]

The expansion of lending outside of bank assessment areas has had a significant impact on the quality and terms of the loans that are made. Studies by staff from the Federal Reserve Board and Joint Center for Housing Studies found that loans made by banks in their assessment areas were less likely to be "higher-cost" (and potentially predatory) than non-CRA assessment area loans. Loans made within banks' assessment areas constituted 31% of lower priced loans to low- and moderate-income areas and borrowers, but only 9% of higher-priced mortgages to those groups.[23] Similarly, 13% of loans by institutions and their affiliates within their assessment areas were "higher-cost" as compared with 41% outside their assessment areas.[24] As these data show, CRA-covered institutions make better loans in areas that are subject to CRA examination. Expanding examination areas to cover the geographies in which institutions actually do business will both make the CRA examinations more reflective of institution's actual compliance, and will improve the quality and cost of credit available to low- and moderate-income households in those areas.

The assessment area is also far too narrowly defined for limited purpose institutions (i.e., those offering a narrow product line such as credit cards). These institutions may designate one assessment area around a headquarters for assessment under the community development test (e.g. Salt Lake or Sioux Falls), regardless of their asset size and notwithstanding their offering credit products across multiple states or nationwide and absorbing large fees from communities across the country.

Similarly, for retail banking companies with significant lending or deposit-taking activities covering a much broader geographic area than their branch locations, the areas they are "chartered to serve" are no longer solely their deposit-taking locations. These institutions' service to their communities is more properly measured by the national scope of their activities, rather than wherever they happen to locate their "bricks and mortar" offices.

Proposed Solutions:

- **Broaden assessment areas to reflect the actual scope of bank activity.**

- **In any state where an institution has at least $10 million in deposits or loans, the institution's CRA compliance should include low- and moderate-income neighborhoods in that state.** This does not mean that every low- or moderate-income neighborhood in the state must receive loans, but rather that, in the aggregate, these communities need to be served at the same market share level that the bank has in other neighborhoods.

2. In recent years, CRA-covered institutions have done substantial lending through affiliates, but affiliate activities currently do not count toward the CRA rating of the related institution.

Much of the large banks' geographic expansion was accomplished through the acquisition of non-depository mortgage banking affiliates. Over the years, CRA-regulated institutions have increasingly conducted their mortgage lending through these affiliates. Yet under current CRA regulations, the lending activities of bank affiliates are not considered in the institution's CRA examination, unless the institution itself so chooses. The result is that a significant proportion of large bank lending activity is shielded from CRA review. This makes no sense, and seriously undercuts CRA compliance.

Much of the affiliate lending merits significant attention for CRA purposes. Affiliates of CRA-regulated institutions accounted for 12 to 13 percent of "higher-cost" mortgages in 2005 and 2006.[25] This lending was frequently predatory and often featured interest rates that increased dramatically in a short period of time, while carrying substantial penalties refinancing prior to the rate increase. Many low- and moderate-income families lost their homes, and many more saw their hard-earned equity stripped away. A large proportion of the families who were steered into these unsustainable loans qualified for less costly, more sustainable loans.[26]

Under current regulations, discriminatory or otherwise illegal credit practices by affiliates do not impact an institution's CRA rating where the institution does not choose to include the affiliate in its CRA evaluation. This actually encourages institutions to make use of the affiliate structure to undermine the purposes of CRA. As stated in a 2004 letter to the Agencies from eight members of the House Financial Services Committee, including then-Ranking Member Frank, "[T]he corporate structure of the financial institution should not be determinative of whether an institution's lending activity is consistent with its obligations under CRA."

As a result of abusive mortgage lending by subprime mortgage lenders including bank affiliates, a large proportion of the economic gains made by African-American and Hispanic families over the last several decades have been wiped out. A study by the Center for Responsible Lending has found that, as a share of the population of homeowners as of 2006, an estimated 17% of Hispanic homeowners, and 11% of African-American homeowners, (as compared with 7% of non-Hispanic white homeowners) already have lost or are at imminent risk of losing their home.[27] The impact on neighborhoods of color is severe: We estimate that between 2009 and 2012, $194 and $177 billion, respectively, will have been drained from African-American and Hispanic communities in the "spillover" affects of nearby foreclosures.[28] Unsustainable and predatory lending destroys wealth and devastates neighborhoods. Such lending by an institution's affiliates should not evade consideration as part of the institution's CRA compliance review.

Proposed Solution:

- **The activities of affiliates – both good and bad – should count toward the CRA rating of the related institution to the same extent as the institution's own activities.** Predatory, unsustainable or discriminatory lending by an affiliate should negatively impact the CRA rating of the related institution.

3. Low- and moderate-income communities and communities of color remain severely under-served by mainstream financial institutions, making them even more vulnerable to high-cost and often predatory alternative institutions and products.

Low- and moderate-income communities and communities of color are largely outside the system of mainstream banking services. A recent FDIC survey found that 7.7% of U.S. households (approximately 17 million adults) are completely unbanked. Adding the number of households that are "under-banked" – that is, those who rely on alternative financial services providers, such as check-cashers, money-order providers, or payday lenders for at least some of their financial needs – the proportion of American households that are inadequately served by mainstream financial institutions is staggering: over one-quarter of U.S. households, comprising approximately 60 million adults nation-wide.[29]

Astoundingly, almost 54% of African-American households are either unbanked or under-banked (21.7 % of African-American households are completely unbanked). The same holds true for 43.3% of Hispanic households (19.4% of Hispanic households are unbanked), and 44.5% of American Indian and Alaskan households (15.6% of American Indian and Alaskan households are completely unbanked).[30]

The FDIC survey revealed that the failure to provide useful, affordable services that make sense for low-dollar accounts is a significant reason why mainstream institutions are not well-suited for underserved consumers. More than one-third of the never-banked households responding to the survey identified not having enough money to need an account as one of their reasons for not having one – suggesting the absence of accounts structured for low-dollar consumers. Other reasons commonly given are high minimum balance requirements, and not writing enough checks to make an account worthwhile. Among the unbanked households that were previously banked, nearly one-third closed their account because of the costs of maintaining it (i.e., minimum balance requirement, service charges, and overdraft fees).[31]

These households' fears of excessive fees are well-founded: In the area of overdraft fees, for example, institutions have charged their customers $23.7 billion per year in overdraft fees to cover overdrafts of $21.3 billion. This means consumers had to repay $45 billion for $21.3 billion in very short-term credit. Low- and moderate-income consumers can ill-afford the risk of incurring such high-cost debt. The FDIC survey findings, and in particular the experiences of previously banked consumers who left due to high fees and costs demonstrate the need for simple, low cost services for clients with small-balance accounts.[32]

Underserved communities pay a high price for relying on banking services outside the mainstream banking system. According to a Brookings Institution study, lower-income families spend hundreds or thousands of extra dollars each year for basic financial services.[33] Without a bank account, it is difficult to establish credit, or to obtain a loan from a mainstream financial institution.[34] It is also difficult to accumulate liquid savings for emergencies, or store cash without risk of theft, loss, or destruction in the event of fire.

With respect to mortgage lending, as noted earlier, communities of color were targeted by non-bank mortgage lenders who provided them with higher-cost, less sustainable loans.[35] These non-bank lenders were in some instances affiliates of CRA-covered institutions whose CRA evaluations did not take into account the frequently predatory nature of their affiliates' lending practices.

Proposed Solutions:

- **Specifically incent fair and affordable savings and transactions services targeted to meet the needs of low- and moderate-income individuals, including the unbanked and under-banked.**
  - CRA examinations should evaluate the extent to which banks offer convenient, affordable transaction and savings products and asset-building activities, for low- and moderate-income people, wherever they live.
- **For banks of all sizes, the "Services Test" should evaluate the characteristics, quality and actual volume of savings and transaction products designed for low- and moderate-income consumers.**
  - CRA credit should apply only for those savings and transaction accounts that are low-fee, no high-cost overdraft, and no or nominal-minimum deposit, accessible at hours and locations suitable to unbanked and under-banked customers.

- **For large banks, change the core criteria for Services Test to include three equally-weighted factors where good performance is required for a Satisfactory rating:**

    - **Demonstrate that reasonable access to services is provided to low- and moderate-income areas and consumers, through delivery systems that include branch distribution and alternative access (e.g. work place, shopping place and remote options), for the full range of banking products.**

    - **Demonstrate access to affordable, transparent transactions and savings accounts specifically designed and marketed to meet the needs of low- and moderate-income consumers.** The bank should be evaluated based on both design of product features and product volume. A showcase product with no volume is show without substance. Institutions' market share for products designed for low- and moderate-income consumers should be level with their market share for other consumers.

    - **Demonstrate a reasonable level and variety of community development services that support asset building for low- and moderate-income consumers and/or address small business needs.**

- **Require large banks to receive at least a "Satisfactory" rating on the new Services Test in order to receive a composite "Satisfactory" rating.**

- **For small and intermediate small banks, add an explicit factor for considering the volume and design of savings and transaction products developed to meet the needs of low- and moderate-income customers.**

4. Low- and moderate-income communities and communities of color are too often forced to rely on extremely high-cost lenders to meet their small-dollar liquidity needs. CRA regulations should encourage institutions to provide affordable small-dollar loans.

Low- and moderate-income consumers and people of color have limited opportunities for obtaining small, affordable consumer loans. According to the 2009 FDIC survey, 28% of unbanked and 40% of under-banked households use alternative credit products such as payday or refund anticipation loans. These products are extremely high-cost, with APRs in the hundreds. Every month, under-banked households divert funds needed for essential purchases in order to service their high-cost consumer debt. As unemployment rises, and family budgets are stretched to the breaking point, high-cost debt service materially undermines the economic stability and health of these families. This in turn stifles economic growth in the non-financial sectors of the economy, where these households would otherwise be spending resources currently diverted toward debt service.

The provision of affordable small consumer loans should be an essential component of institutions' service to these communities. Yet, currently, consumer lending is not an important element of the great majority of CRA examinations.[36] Moreover, credit card and other "limited purpose" banks are not evaluated at all based on consumer lending, but solely on a "Community Development Test." These tests should be revised to more accurately measure these institutions' provision of fair and affordable small loan products to low- and moderate-income individuals.

<u>Proposed Solutions:</u>

- **Change CRA regulations to clearly provide an incentive for institutions of all sizes to address the small-dollar consumer lending needs of low- and moderate-income individuals.** This does not mean short-term loans, but rather small-dollar loans. **For example:**

    - **For large banks: Consistently include consumer lending programs designed for, and made accessible to, low- and moderate-income people in the "Lending Test," and require data collection to document the targeted loans.**

    - **For limited-purpose banks (generally offering one credit product, such as a credit card or auto loans): Add a criterion to the existing Community Development Test to encourage innovative and effective access to affordable, small-dollar loans or other affordable credit for low- and moderate-income individuals.**

    - **For small and intermediate small banks: Place more emphasis on small consumer loan programs in the small bank lending test, particularly as a factor in obtaining a high satisfactory or outstanding rating.**

5. CRA Regulations do not adequately incent fair and affordable small business loans for low- and moderate-income individuals.

As with small consumer dollar loans, there is a need for affordable small business loans for low- and moderate income individuals and those seeking to open small businesses in low- and moderate income communities.

Proposed Solution:

- **Strengthen incentives for fair and affordable small business loans for low- and moderate-income individuals, and require data reporting to facilitate compliance evaluation.**

6. Low- and moderate-income communities are being destroyed by wide-spread foreclosures, many of which could be avoided with economically-rational loan modifications that would render the loan sustainable for the homeowner.

The most recent data from the Mortgage Bankers Association's report on home loan delinquencies revealed that one in seven homeowners with a mortgage is now past due or in foreclosure.[37] That's up from one in eight a year ago and one in 11 two years ago. Yet efforts to encourage lenders to modify foreclosure-bound mortgages to render them sustainable for current homeowners have not met with much success. Just last week, the State Foreclosure Prevention Working Group issued a report showing that over 60% of seriously delinquent borrowers are not getting any assistance at all from their mortgage servicing company.[38] Without a substantial increase in loan modification efforts, the Center for Responsible Lending estimates that a total of 9 million homes will have been lost to foreclosure from 2009-2012.[39]

As noted above, the spillover effects of these foreclosures harm whole communities, including homeowners who remain current on their loans, and these impacts are disproportionately felt by low- and moderate-income communities and communities of color.

Loan modifications that reduce the principal balance of the loan to, or near, the home's current market value and reduce the interest rate to level that is sustainable at the homeowner's current income are in the best interest of creditor—who cannot recover more than the home's value through a foreclosure sale—as well as the homeowner and the surrounding community. By incenting lenders to provide low- and moderate-income homeowners with modifications that enable them to remain in their homes and rebuild their equity, the banking agencies can help stem the tide of foreclosures and promote economic recovery in these communities.

Proposed Solution:

- **Incent sustainable mortgage loan modifications for low- and moderate-income individuals and communities that reduce principal balances to, or near, the current value of the mortgaged property and reduce interest rates sufficiently to render the loan affordable at the borrower's current income.**

7. Community development financial institutions have expertise in meeting the needs of under-served communities, and this expertise can be leveraged by encouraging CRA-covered institutions to support them.

CDFIs provide responsible services to under-served communities. In addition to serving low- and moderate-income households with direct loans, savings accounts, and other financial services, CDFIs also fund revitalization projects in low- and moderate-income communities. These projects improve the safety and quality of life in these communities, stabilize the housing stock and enable small businesses to establish themselves. Many low- and moderate-income communities have been devastated in the recent crisis, and are urgently in need of assistance to rebuild. CDFIs are critical to this effort.

CDFIs did not even exist in 1977. Today, the Department of the Treasury through its CDFI Fund has a process for certifying CDFIs and supporting their work. The banking agencies have the opportunity through CRA regulations to expand CDFIs' capacity for supporting and revitalizing underserved communities. The regulations should encourage bank lending and investment in CDFIs for community development purposes, i.e., affordable housing, community services for low- and moderate-income individuals, financing economic development for small businesses and community revitalization of low- and moderate-income or distressed areas.

Proposed Solutions:

- **More effectively incent loans and investments for community development projects—not as a substitute for, but in addition to, direct service to low- and moderate-income individuals. All institutions, regardless of size, should be evaluated on their community development loans and investments.** (The institution's size and capacity should be taken into account in determining the extent of appropriate community development loans and investments). **Some specific approaches could include:**

    - **Separate consideration of community development lending from the retail lending test and consider it with community development investments as part of a new community development test for all large banks.** The test would measure financing through lending or investments in community development purpose projects. It would also continue to favorably consider targeted grant funding.

    - **Require large banks be to achieve at least a "Satisfactory" rating for the community development**

test in order to receive a composite "Satisfactory" rating.

- **Require that small banks be regularly evaluated for community development lending or investments as part of their core evaluation, rather than for "extra credit."**

- **Enable banks to include community development loans or investments in their CRA evaluation regardless of whether they are part of their normal geographic assessment area, if they achieved a "Satisfactory" on all tests at their last examination.**

8. CRA evaluations have not properly assessed, encouraged or rewarded institutions' CRA compliance, and have not imposed sufficient negative consequences for non-compliance.

The current CRA evaluation system neither properly assesses nor encourages CRA compliance. A large part of the problem is grade-inflation – that is, the vast majority of institutions receive very favorable assessments despite a wide range of performance records. And the range of grades is too narrow to properly distinguish excellent performance from the mediocre or wholly inadequate. In addition, while CRA exams entail several components – large banks are evaluated by lending, services and community development tests – it is too easy for institutions to achieve high ratings overall while underperforming on one of the component tests.

Similarly, it is too easy for institutions to receive positive ratings notwithstanding discriminatory or predatory lending or bank accounts with high overdraft fees and other wealth-stripping features, whether by the institution itself or by affiliates, or outside the institution's assessment area.

Ninety percent of all banks receive a composite "Satisfactory" rating. Less than 1% of banks receive a "Needs to Improve" or a "Substantial Noncompliance" rating. Approximately 9% of all banks receive "Outstanding" ratings. Of the largest institutions, those with over $10 billion in assets, the majority are receiving "Outstanding" ratings. They receive an "Outstanding" rating notwithstanding their engagement in wealth-stripping practices, such as high-cost overdraft programs that have a disparate impact on lower income communities and communities of color. Thus they have limited incentives to engage in activities that address CRA objectives at a higher level or to strengthen performance.

The CRA rating system is the only enforcement mechanism for CRA compliance. Failures in CRA ratings process thus undermine the CRA overall. Improvements are critical and must ensure that only truly satisfactory compliance achieves a "Satisfactory" rating, and only those institutions whose performance is outstanding receive the agency endorsement associated with an "Outstanding" rating.

Proposed Solutions:

- **Make the CRA ratings system more meaningful by ensuring a transparent, public evaluation that reflects significant differences in bank performance. Implement real consequences, such as fines or similar disincentives, for less than satisfactory ratings. Consider offering concrete benefits for truly outstanding performance.**

  - **Include in the CRA regulation a provision that if an institution makes loans that are not affordable or not sustainable or are otherwise in compliance with regulation or regulatory guidance, such loans will not be considered as responsive to community needs for a positive rating and will negatively affect the CRA rating.**

  - **For all banks, revise the ratings approach to differentiate levels of satisfactory performance. Composite bank, State and multi-state MSA ratings should include a short descriptor that designates "high" and "low" satisfactory or simply "satisfactory" performance.**

  - **Include the above descriptions in monthly ratings press releases and on the FFIEC web sites. Also, enhance the searchable database of all available bank ratings, including composite and, where applicable, test ratings at the State and multi-state MSA levels.**

  - **For large banks, consider each test to have equal weight, requiring a satisfactory level of performance in each to receive a composite rating of "Satisfactory."**

  - **For large banks, in each test, add more specific performance criteria to clarify what is needed for a "Low Satisfactory", "Satisfactory," "High Satisfactory" or "Outstanding" rating.**

  - **Institutions that receive a less than "Satisfactory" rating should be required to pay a fine into a fund to be used to meet the credit and investment needs of low- and moderate-income individuals within the relevant communities.**

9. Recent studies have shown that race is an independent factor (apart from credit-worthiness) in determining access to credit and credit terms, yet CRA examinations do not adequately assess the extent to which institutions are actually lending in communities of color.

As noted above, in the run-up to the subprime lending crisis, homeowners of color were more likely to be steered into abusive subprime loans than comparably qualified white homeowners, even where they qualified for more sustainable prime loans. A CRL study showed that African-American and Latino borrowers were more likely to receive higher-rate subprime loans than white borrowers with similar risk profiles, while another study provided evidence that loans in minority communities were more likely to carry prepayment penalties than loans in white communities, even after controlling for other factors.[40] Risky loan products—especially subprime mortgage loans—have been shown to be more likely to default than safer loans made to comparably qualified borrowers.[41] This is one of the reasons why communities of color, steered into the most abusive products, have been disproportionately impacted by the current foreclosure crisis.[42]

Many families facing the loss of their homes would not be facing foreclosure had they received the lower-cost, less explosive loans for which they qualified. Yet, while CRA examinations purport to assess whether banks violated fair lending laws by rejecting qualified minority applicants, they do not adequately assess the extent to which banks are actually lending to minorities. An institution that does not market to communities of color may not be found to have violated fair lending laws, but will not be serving those communities. CRA examinations should include an assessment of institutions' lending to communities of color.

<u>Proposed Solution:</u>

- **Revise CRA examinations to scrutinize lending, investing, and service to minorities and communities of color, to ensure that institutions are meeting the needs of all segments of the communities they are chartered to serve.** Facilitate such scrutiny by collecting HMDA-type data on consumer loans, and small business loans. Make such data publicly available, along with a detailed description of the agency's assessment of the institution's lending to minority communities.

III. Conclusion

Basic banking services, including affordable credit as well as savings and transactional accounts, are essential to the accumulation of wealth, economic opportunity and financial stability. Low- and moderate-income communities and people of color continue to lag behind white middle class families in their access to these fundamental services, putting them at a severe economic disadvantage, and costing each such family hundreds or thousands of dollars annually in high-cost debt service and fees that would otherwise be saved, or directed toward the families' other needs.

These communities have been particularly devastated by the epidemic of foreclosures on subprime mortgage loans, in which depository institutions invested heavily. Even before the subprime lending spree, mainstream banking institutions have had a well-justified CRA-imposed legal obligation to serve all communities in which they transact significant business. But modern banking outpaced CRA regulations, and CRA has not been as effective as it could, and needs to, be. To remain relevant, CRA regulations must be modernized to bring them up to date with technological, regulatory and market changes. With the reforms discussed herein, the banking agencies will go a long way toward helping low- and moderate-income individuals and families to achieve financial stability, rebuild their communities, and to participate in the opportunities our economy has to offer. This is the promise of CRA, and the obligation of all covered institutions.

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[1] Federal Reserve Board Chairman Ben S. Bernanke, "The Community Reinvestment Act: Its Evolution and New Challenges," Speech at the Community Affairs Research Conference, Washington, D.C. (March 30, 2007) http://www.federalreserve.gov/newsevents/speech/Bernanke20070330a.htm#f2

[2] FDIC National Survey of Unbanked and Underbanked Households (Dec. 2009) at 15 http://www.fdic.gov/householdsurvey/ ("FDIC Survey")

[3] Vertical Capital Solutions, Historical Performance of Qualified vs. Non-Qualified Mortgage Loans, February 2010 (on file with CRL) (30 percent of the borrowers in the sample, which included all types of loans and borrowers, could have received a safer loan); *see also* Rick Brooks and Ruth Simon, *Subprime Debacle Traps Even Very Credit-Worthy As Housing Boomed, Industry Pushed Loans To a Broader Market*, Wall Street Journal at A1 (Dec. 3, 2007) (61 percent of subprime loans originated in 2006 "went to people with credit scores high enough to often qualify for conventional [i.e., prime] loans with far better terms.").

[4] Higher-rate conventional mortgages were disproportionately distributed to borrowers of color, including African-American, Latino, American Indians, Alaskan Natives, Native Hawaiians, Pacific Islanders, and Hispanic borrowers. *See* R.B. Avery, G.B. Canner, and R.E. Cook, Summer 2005. "New Information Reported under HMDA and Its Application in Fair Lending Enforcement," Federal Reserve Bulletin (available at http://www.federalreserve.gov/pubs/bulletin/2005/summer05_hmda.pdf); R.B. Avery, K.P. Brevoort, and G.B. Canner, September 2006. "Higher-Priced Home Lending and the 2005 HMDA Data," Federal Reserve Bulletin (available at http://www.federalreserve.gov/pubs/bulletin/2006/hmda/bull06hmda.pdf); R.B. Avery, K.P. Brevoort, and G.B. Canner, December 2007. "The 2006 HMDA Data" Federal Reserve Bulletin (available at http://www.federalreserve.gov/pubs/bulletin/2007/pdf/hmda06final.pdf); R.B. Avery, K.P. Brevoort, G.B. Canner, December 2008. "The 2007 HMDA Data", Federal Reserve Bulletin (available at http://www.federalreserve.gov/pubs/bulletin/2008/pdf/hmda07final.pdf); R.B. Avery, K.P. Brevoort, G.B. Canner, September 2009, "The 2008 HMDA Data", forthcoming in Federal Reserve Bulletin (available at http://www.federalreserve.gov/pubs/bulletin/2009/pdf/hmda08draft2.pdf).
See also Debbie Gruenstein Bocian, Keith Ernst and Wei Lee, "Race, Ethnicity and Subprime Loan Pricing." Journal of Economics and Business, Vol. 60, Issues 1-2, January-February 2008, at 110-124; *see also* "Debbie Gruenstein Bocian and Richard Zhai, "Borrowers in High Minority Areas More Likely to Receive Prepayment Penalties on Subprime Loans,"January 2005, available at http://www.responsiblelending.org/mediacenter/press-releases/archives/rr004-PPP_Minority_Neighborhoods-0105.pdf

[5] *See* E. Laderman and C. Reid, "CRA Lending During the Subprime Meltdown," at 118, available at http://www.frbsf.org/publications/community/cra/cra_lending_during_subprime_meltdown.pdf

[6] *See Id.*; L. Ding, R. Quercia, W. Li and J. Ratcliffe, "Risky Borrowers or Risky Mortgages: Disaggregating Effects Using Propensity Score Models," (Revised May 17, 2010), available at http://aux.zicklin.baruch.cuny.edu/jrer/papers/pdf/forth/accepted/Risky%20Borrowers%20or%20Risky%20

Mortgages.pdf at 3 (finding that for borrowers with similar risk characteristics, the estimated default risk with a CRA-covered loan through a special lending program through Self-Help is about 70 percent lower than with a subprime mortgage).

[7] Across the United States, a total of 91,516,008 homes have lost collectively $1.9 trillion in value due to nearby foreclosures. The loss of home equity, in many cases leaving homes worth less then their outstanding mortgage, leaves homeowners with less ability to refinance or sell, and less of a financial cushion with which to withstand short-term financial set-backs. The spillover effects of nearby foreclosures thus diminishes household wealth and increases foreclosure risk for families who are current on their mortgage. *See* data compiled by the Center for Responsible Lending at http://www.responsiblelending.org/mortgage-lending/tools-resources/factsheets/united-states.html; *see also* Center for Responsible Lending, Soaring Spillover: Accelerating Foreclosures to Cost Neighbors $502 Billion in 2009 Alone; 69.5 Million Homes Lose $7,200 on Average (May 2009) available at http://www.responsiblelending.org/mortgage-lending/research-analysis/soaring-spillover-3-09.pdf

[8] Canner and Bhutta, "Staff Analysis of the Relationship between the CRA and the Subprime Crisis" (Nov. 2008) www.federalreserve.gov/newsevents/speech/20081203_analysis.pdf at 7.

[9] E. Laderman and C. Reid, *supra* at 123.

[10] *See* E. Luce, "Few Escape Blame Over Subprime Explosion," The Financial Times (May 6, 2009) (reporting on investigation by The Center for Public Integrity showing that at least 21 of the 25 top subprime originators were either owned or financed by the biggest recipients of troubled asset relief funds, including Citibank, Bank of America, Wells Fargo and JPMorgan).

[11] "The CRA within a Changing Financial Landscape," Avery, Courchane and Zorn (Feb. 2009) at 41 www.frbsf.org/publications/community/cra/cra_within_changing_financial_landscape.pdf (hereafter "Avery, Courchane and Zorn").

[12] Canner and Bhutta at 7.

[13] "CRA Special Lending Programs," Avery, Bostic and Canner, Federal Reserve Bulletin (Nov. 2000) at 723, www.federalreserve.gov/pubs/bulletin/2000/1100lead.pdf (Ninety-three percent of responding CRA-covered institutions so reported).

[14] Board of Governors of the Federal Reserve System, "The Performance and Profitability of CRA-Related Lending, A report submitted to Congress pursuant to Section 713 of the Gramm-Leach-Bliley Act of 1999." (July, 17, 2000) at 45-46, www.federalreserve.gov/boarddocs/surveys/craloansurvey/cratext.pdf

[15] The CDFI Data Project, Fiscal Year 2007, Seventh Edition, "Providing Capital, Building Communities, Creating Impact" http://www.opportunityfinance.net/industry/industry_sub1.aspx?id=248

[16] Staff Analysis of the Relationship between the CRA and the Subprime Crisis, Nov. 21, 2008, Board of Governors of the Federal Reserve, Division of Research and Statistics (available at http://www.federalreserve.gov/newsevents/speech/20081203_analysis.pdf).

[17] *See Id.*; OCC Press Release, "Comptroller Dugan Says CRA not Responsible for Subprime Lending Abuses" (Nov. 19, 2008), available at http://www.occ.treas.gov/ftp/release/2008-136.htm ("CRA is not the culprit behind the subprime mortgage lending abuses, or the broader credit quality issues in the marketplace," Mr. Dugan said in a speech to the Enterprise Annual Network Conference. "Indeed, the lenders most prominently associated with subprime mortgage lending abuses and high rates of foreclosure are lenders not subject to CRA," he added. "A recent study of 2006 Home Mortgage Disclosure Act data showed that banks subject to CRA and their affiliates originated or purchased only six percent of the reported high cost loans made to lower-income borrowers within their CRA assessment areas.")

[18] OCC-promulgated CRA Regulations, 12 C.F.R. § 25.41.

[19] Avery, Courchane and Zorn at 35, 36.

[20] Avery, Courchane and Zorn at 41; ; s*ee also* Essene and Apgar, "The 30th Anniversary of CRA: Restructuring CRA to Address the Mortgage Finance Revolution" (Feb. 2009) at 22-24 http://www.frbsf.org/publications/community/cra/30th_anniversary_cra.pdf

[21] The market share of total deposits held by top 25 CRA-regulated institutions grew from under 20% in 1977 to over 50% by 2007. Similarly, the top 25 institutions held 15% of consumer loan dollars in 1977, and held fully 70% in 2007. Avery, Courchane and Zorn at 36.

[22] Avery, Courchane and Zorn at 41.

[23] Essene and Apgar at 25.

[24] Canner and Bhutta at 8.

[25] Canner and Bhutta, “Staff Analysis of the Relationship between the CRA and the Subprime Crisis” (Nov. 2008) at 7, www.federalreserve.gov/newsevents/speech/20081203_analysis.pdf

[26] See Congressional Oversight Panel, Special Report on Regulatory Reform(2009) http://cop.senate.gov/documents/cop-012909-report-regulatoryreform.pdf at 31; Even those homeowners who could not qualify for prime loans, frequently could have received a less costly and more sustainable fixed rate loan instead of the explosive adjustable rate loan subprime lenders typically gave them. *See* E. Harnick, “The Crisis in Housing and Housing Finance: What Caused It? What Didn’t? What’s Next?,” 31 WNEC L.Rev. 625, 629-30 (2009) available at http://assets.wnec.edu/170/28_arti_Crisis_i.pdf

[27] D. Bocian, W. Li and K. Ernst, “Foreclosures by Race and Ethnicity: The Demographics of a Crisis (June 18, 2010) at 3, www.responsiblelending.org/mortgage-lending/research-analysis/foreclosures-by-race-and-ethnicity.pdf

[28] Id.

[29] FDIC Survey at 11.

[30] FDIC Survey at 10.

[31] FDIC Survey at 24-25.

[32] Center For Responsible Lending, “Quick Facts on Overdraft Loans,” http://www.responsiblelending.org/overdraft-loans/research-analysis/quick-facts-on-overdraft-loans.html last visited on July 12, 2010.

[33] Matt Fellowes, “From Poverty, Opportunity: Putting the market to Work for Lower Income Families” at 20-35 (The Brookings Institution Metropolitan Policy Program, July 2006) http://www.brookings.edu/metro/pubs/20060718_findings.pdf

[34] Michael S. Barr, “Banking the Poor,” 21 Yale J. on Reg. 121, 138 (2004).

[35] See Bocian, Ernst and Li, Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages (May 31, 2006).

[36] Under the Large Bank lending test, consumer lending is only required to be reviewed if it is a “substantial majority” of the bank’s business or, for targeted small-dollar loan programs, if requested by the bank (as “responsive lending activities”). Large banks have approximately 15% of assets in consumer lending (June 30, 2009 call report data). Participation in consumer lending is not necessarily considered under the small and intermediate small bank performance criteria.

[37] Mortgage Bankers Association National Delinquency Survey (Aug. 2010).

[38] “Redefault Rates Improve for Recent Loan Modifications,” State Foreclosure Prevention Working Group Memorandum on Loan Modification Performance (Aug. 2010), available at http://www.csbs.org/regulatory/Documents/SFPWG/DataReportAug2010.pdf

[39] *See* current estimates of the Center for Responsible Lending based on data from the Mortgage Bankers Association and the Hope Now Alliance, available at www.responsiblelending.org/mortgage-lending/tools-resources/factsheets/united-states.html

[40] *See* notes 4 & 5 and surrounding text.

[41] *See* Ding, Quercia, Li and Ratcliffe.

[42] *See* Bocian, Li and Ernst, “Foreclosures by Race and Ethnicity: The Demographics of a Crisis (June 18, 2010) at 3; *see also* T. Jayasundera, J. Silver, K. Anacker and D. Mantcheva, “Foreclosure in the Nation’s Capital: How Unfair and Reckless Lending Undermines Homeownership,” National Community Reinvestment Coalition (Apr. 28, 2010), available at http://www.ncrc.org/index.php?option=com_content&view=article&id=580:foreclosure-in-the-nations-capital-how-unfair-and-reckless-lending-undermines-homeownership&catid=25:reports-and-research-library&Itemid=76