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Community Reinvestment Act Hearings

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Can Effective CRA Reform Close the Growing Racial Wealth Gap?

The Greenlining Institute thanks the Federal Reserve, the FDIC, the OCC, and the OTS for this timely review of the Community Reinvestment Act (CRA). Thank you for inviting Greenlining to address this panel on such an important issue.

As I speak, we are witnessing an unprecedented loss of wealth in communities of color across the nation. A leading reason for this loss of wealth is the growing loss of home equity. According to the Center for Responsible Lending, widespread foreclosures have drained an estimated $350 billion from communities of color. For every 100 African American homeowners, 11 have either lost their homes or at risk of foreclosure. For Latino families, the figures are worse: 17 of every 100 Latino homeowners are touched by foreclosures (Center for Responsible Lending).

While foreclosures in communities of color are a key part of the picture, they are certainly not the whole picture. After being denied the opportunity to build assets for so long, our communities saw brief glimmers of opportunity, only to see new assets stripped away in recent years.

Beyond losing their homes, people in our communities have been the last hired and first hired and have lost a disproportionate number of small businesses. Latinos and African Americans currently face unemployment of crisis proportions: 12.1% in the Latino community and 15.6% in the African American community. From 2008 to 2009, SBA lending declined across the board, but declined an incredible 61.5% for African American owned businesses and 59.3% for Latino owned businesses. These figures are even worse in California.

Additional factors exacerbate the wealth gap for communities of color:

- Over 25 million households in America do not have bank accounts, of which 80 percent are people of color: African Americans (46 percent) and Latinos (34 percent). This means that people of color are 4 to 5 times more likely than whites to be unbanked.
- Payday lenders are nearly eight times more concentrated in California's African American and Latino neighborhoods as compared to white neighborhoods, draining these communities of $247 million in payday loan fees[1]
- 52% of African American children and 54% of Latino children start life with no significant savings[2]
- 43.4% of whites have retirement accounts as opposed to just 18% of people of color.[3]

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[1]Center for Responsible Lending http://www.reuters.com/article/pressRelease/idUS232768+26-Mar-2009+PRN20090326
[2]http://www.abagmd.org/usr_doc/Family_Funder_Spotlight_Vol_8_Haas_Fund.pdf via The Hidden Cost of being African American: How Wealth Perpetuates Inequality by Thomas Shapiro

All of this has led to a growing racial wealth gap. For every dollar of wealth owned by a white family, an African American or Latino family owns just 16 cents (NY Times, 5/30/10). This translates to less of a safety net in troubled times, and less money to invest in college educations or small business ventures. We know that the same trends exist within the Asian American community as well, but unfortunately these trends are hidden unless we disaggregate the data for Asian Americans.

The overall financial health of our communities is critical to America's overall economic recovery. We will sink or swim together. In a sense, communities of color have become canaries in the coal mine of the economic crisis. While the nation has endured a recession, too many in our communities have experienced a depression. Our victimization by predatory lenders and loss of jobs, homes and businesses has devastated our local economies, but could also hamstring the health and wealth of the entire society.

The modernization and enhancement of the Community Reinvestment Act has the potential to address many of these inequalities and avert their ripple effect across the economy. However, as it is written today, CRA lacks the power to truly address the inequities that are contributing to the growing racial wealth gap. This is in part because CRA places the onus of responsibility on the very people who suffer from the inequalities it seeks to address. It is often left to community advocates to seek out the data that reflects the commitment of banks to the communities that they serve and to hold them accountable for their shortcomings. Despite the strengths of CRA, we know it can't be effective unless it is embraced and promoted by regulators and financial institutions. We are therefore pleased that the federal regulators are proactively seeking input through these hearings.

Recommendations

Given the magnitude of the crisis facing communities today, Greenlining recommends the following for immediate implementation:

1. <u>Immediately place diversity front and center in the application of CRA.</u>

First and foremost, we must embrace the fact that diversity matters. Unless and until the boards and executive management teams at financial institutions reflect the diversity of the customers they serve, we cannot truly have a "safe and sound" banking system.

Urging banks to diversify their staffs, the Boston Federal Reserve Bank has said that diverse staffs at banks "can create an environment in which minority applicants feel welcome, strengthen ties to minority communities, and design policies and products that more effectively meet the needs of minority consumers."

The 2009 Greenlining annual board diversity report shows that in California, people of color represent 60% of the population, yet corporate board structures are nowhere near that level of diversity. Senator Robert Menendez's new Fortune 500 diversity study shows similar troubling results at the national level: African Americans represent 8.77% of all board members in his

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[3] United for a Fair Economy's State of the Dream 2009

sample, and Latinos a mere 3.28% of board members. Diversity at the management level is equally bleak: in 2008, white males held 64 percent of all senior positions in the financial services industry, compared with 2.8% of all African Americans, 3% of Latinos, and 3.5% of Asian Americans.[4]

This is despite research from CalPERS (the nation's largest pension fund, serving California's retired public employees) that shows that diverse boards produce "higher performance on financial metrics such as: return on equity, return on sales, and return on invested capital." CRA ratings must take into account the extent to which a financial institution commits to diversity in the workplace, diversity in marketing and outreach, and among executive management.

2. Immediately add supplier diversity to the CRA evaluation process.

The rapid hemorrhaging of jobs and assets in our communities can be at least partially addressed through better attention to the needs of minority-owned businesses. Minority business contracting, or "supplier diversity", needs to be added to CRA consideration. Minority-led businesses are among the top job creators in low-income communities and communities of color and are central to building community assets, but too many smaller minority-owned businesses are being shut out of contracts, finding themselves crunched by tightened credit, and facing bankruptcy.

In July 2010, the U.S. Census Bureau announced that the number of minority-owned firms increased by 46 percent to 5.8 million between 2002 and 2007. While the number of minority-owned businesses continues to grow, they are still smaller in size and scale compared to non-minority-owned firms. In 2007, average gross receipts for minority-owned firms were $179,000 – a mere 36.5% of gross receipts for non-minority-owned firms, which had average gross receipts of $490,000. Despite this increase in minority-owned firms, Greenlining estimates that 95% of contracts go to white owned firms.[5]

To leverage CRA's impact on job creation through minority business contracting, we propose application of a tremendously successful California model at the national level. The California Public Utilities Commission's "General Order 156" (GO 156) has placed California light years ahead of other states in minority business contracting, simply by encouraging all regulated entities to award a fair portion of contracts to diverse suppliers. Two key elements have made GO 156 successful: the setting of *voluntary* procurement goals and transparency, through annual reports, about progress toward these voluntary goals. GO 156 has moved the supplier diversity of major utilities and telecoms in California to as high as 30% (while they hover around 5% in many other states) through simple goal setting and transparency, and without any quotas or mandates.

In light of the crisis facing minority-owned businesses, this model should be urgently be replicated by the federal financial regulators. Under an enhanced CRA, each of your agencies could require banks to submit annual reports on their supplier diversity figures and to participate

[4] GAO: Financial Services Industry: Overall Trends in Management Level Diversity and Diversity Initiatives, 1993-2008, published May 12, 2010

[5] http://www.census.gov/econ/sbo/

in an annual hearing to discuss their reports. Together you could then establish a joint clearinghouse to assemble and publicize this data.

Additionally, now that the Dodd/Frank bill has overturned Regulation B, CRA has renewed potential. The existing federal regulators should coordinate with the Consumer Financial Protection Bureau to make good use of the new small business lending data that will be collected.

3. <u>Adapt that rating system to incentivize innovation.</u>

The current CRA rating system has never figured out how to reward unique leadership efforts. We therefore see "satisfactory" ratings for occasionally extraordinary leadership or “outstanding” ratings for mediocre efforts.

Greenlining proposes adding more grades to the rating system, including a new rating of "outstanding plus", that are restricted to less than 5 percent of financial institutions. Financial institutions that fail to meet the standards of their competitors would receive "needs to improve" ratings so that at a minimum, at least 10 percent of the institutions receive this rating. Incentives (like, for example, reduced FDIC assessment premiums) could also be offered for “outstanding plus”.

Best practices should be highlighted and rewarded. While instances are indeed presently too few and far between, banks should be able to receive CRA credit by meeting the needs of communities through responsible innovations. In the midst of much discussion about a return to conventional lending products, the availability of these products should not preclude creative, innovative, and *safe* products that have less conventional terms. Such innovation should be highlighted as best practices and rewarded with credit under a revised CRA.

In addition, a “community development” test should be added to the current lending, investment, and services test under CRA. Such a test would take into account a financial institution’s role in overall community development, a field that has blossomed since both the original enactment and the 1995 revisions of CRA. Lending to and investment in community health clinics, community-based loan funds, green affordable housing construction, and other innovative methods of closing the racial wealth gap should receive credit.

Just as the financial sector has changed, our communities have also changed. Models for community economic improvement have come a long way. Many asset and wealth building initiatives have proven successful, and a renewed CRA can work to support the further development of these initiatives.

4. <u>Expand CRA to all industries that provide financial products.</u>

The financial sector of the 1970s, when CRA was enacted, would be unrecognizable today. Many financial services critical to wealth creation are now provided by institutions not covered by CRA. A modernized CRA must be expanded to cover these other industries, including investment banks, insurance, hedge funds, private equity firms, and of course any troubled institution that benefits from federal intervention.

Former Federal Reserve Chairman Alan Greenspan himself recently acknowledged that federal regulators were not proactive enough in protecting consumers from fraudulent practices. We have already seen the federal regulators expand their powers beyond their traditional limits in the case of their support of AIG. Given this new perspective, we urge the federal regulators to take similar initiative to expand the purview of CRA to these unregulated industries.

5. <u>Make CRA matter again.</u>

The world has changed since CRA was enacted in 1977, and CRA's failure to keep up has diminished its effectiveness. We can make CRA matter again.

Real enforcement is a start. As you will hear from every community advocate here, enforcement of CRA has been minimal, and there should be harsher fines and penalties for non-compliance. Because of the failure of official regulatory enforcement, it has fallen upon many advocacy groups, including Greenlining, to guarantee the promise of CRA by playing an outside enforcement role.

Again, a revised rating system is necessary. Failure in dealing with our communities must be addressed in the ratings. We see many "outstanding" ratings for failures of both leadership and effective service to the community. For example, the present reality of banks having dismal lending to African Americans, and still receiving outstanding CRA ratings, must end.

Finally, CRA ratings are currently referenced mainly during mergers and acquisitions. The consolidation of financial institutions has made these less likely, diminishing both the opportunity for consumers to comment on CRA ratings and the overall importance of CRA ratings themselves. We therefore urge federal regulators to create systematic opportunities, such as annual hearings, for consumers to comment on the performance of banks. This will enhance the impact of CRA in our current economic reality.

Conclusion

Once again I thank you for the opportunity to share Greenlining's views on the future of CRA and I look forward to your questions.