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advocate's guide to the community reinvestment act

The What, Why, and How of CRA

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What is CRA?

The Community Reinvestment Act (CRA) was passed in 1977 in response to redlining, the illegal practice of not investing in low-income and minority communities. Specifically, the law calls for the federal government to encourage banks to meet the credit needs of the local communities in which they operate.

CRA has been successful in increasing access to financial services for low-and-moderate income communities across the country. As a result, CRA has created jobs, expanded homeownership opportunities, helped small businesses grow and has increased access to affordable housing for many communities.

In 2000, major banks in California made more than $30 billion in lending and investments through their CRA commitments. (Major banks include: Bank of America, California Federal Bank, U.S. Bank, Union Bank of CA, Washington Mutual Bank, and Wells Fargo.)

What is redlining?

Redlining is the illegal business practice of avoiding certain communities on the basis of race, income, and location. In the specific context of CRA, banks were accused of redlining because they took deposits out of poor communities of color, but only made loans to wealthier areas.

CRA has led to successful partnerships between community groups and banks that have led to a fundamental change in the way banks treat low-income communities—from burdens to profitable markets. CRA commitments have been applied towards community development projects United States like affordable housing, community health centers, and small business lending[1].

What CRA Is Not

Despite the achievements of CRA, it is limited in the scope of what it can require banks to do.

- CRA does not force banks to operate outside of their original mission .
- CRA does not require banks to make risky loans that will hurt their profits.
- CRA does not create quotas.
- CRA does not limit the geographic area in which a bank can make loans and it does not require banks to make a specific proportion of loans in any particular geographic area.
- CRA does not require any bank to make every type of loan or meet all community needs alone. Banks may specialize by product type.

CRA: A Scapegoat for the Financial Crisis

Recently, CRA has been blamed with causing the financial crisis. As CNBC host Larry Kudlow falsely argued, "The Community Reinvestment Act…literally pushed these lenders to make low-income loans." Neil Cavuto, a Fox News anchor, took the false argument one step further, saying, "[l]oaning to minorities and risky folks is a disaster." Critics have claimed that the CRA forced banks to extend risky loans to unqualified borrowers.

However, the data clearly shows that the subprime crisis is not a result of too much regulation but rather the result of nonexistent regulation. Specifically:

- Only 25% of the subprime mortgages that are now causing the collapse of the credit markets were originated by CRA-regulated institutions. The remaining 75% of subprime mortgages were originated by independent mortgage brokers or by lightly regulated subsidiaries of regulated banks[2].

- Banks subject to CRA are about two-thirds less likely to offer borrowers high cost mortgage loans. Half of the subprime loans were not made by federally insured banks (FDIC) or CRA approved banks, but instead by independent lenders[3].

- 34.3% of mortgage loans issues by non-CRA lenders were high cost/ risk loans in 2005. By contrast, those institutions that were closely examined by CRA only issued 5.1% of high cost/risk loans[4].

Strengthening CRA

CRA hasn't been perfect, but it has been immensely successful, especially where community groups have organized to develop public-private partnerships with

The Home Mortgage Disclosure Act (HMDA)
How is race/ethnicity data collected for home loans?

The Home Mortgage Disclosure Act (HMDA) was enacted by Congress in 1975 to bring transparency to the private mortgage origination industry. It requires lenders to disclose the income, race, and gender of borrowers, as well as the number and dollar amount of the loans made.

HMDA is a key component of CRA and is a model for how transparency in lending can benefit consumers and lenders by promoting increased lending in underserved areas and highlighting untapped markets for lenders to serve with fairly priced products. As our banking system evolves, the model established by HMDA should be replicated for other types of lending such as business loans to ensure transparency and accountability.

banks. CRA has helped banks find profitable markets that they had otherwise been avoiding.

However, more needs to be done. Approximately 28 million people in the U.S. are still unbanked. People of color are disproportionately represented, with almost 25% of African Americans and Latinos lack basic bank accounts[5]. In 2007, home lending to lower-income African Americans decreased by 72% and lending to Latinos in all income groups fell by almost 40%. CRA is a good starting point, but the banking system can do much more to meet the credit needs of low income communities and communities of color.

Now is the time to strengthen CRA. As our nation grows more diverse and our banking system more complex, it is important that CRA evolve to meet these new challenges. CRA needs to be strengthened so that it can be most relevant and effective at meeting the needs of our country's low-income families and its 110 million people of color. In order for this to happen, we suggest the following improvements to CRA:

Make CRA applicable to all financial institutions

CRA should be extended to reach all sectors of the financial industry. Without being held to the "safety and soundness" standard of CRA, these institutions were able to easily offer dangerous products without any consumer safeguards. It is crucial that the same safeguards that apply to the banks be expanded to other financial institutions.

In order to prevent future crises, the Greenlining Institute advocates for the expansion of CRA-like policies to every type of financial institution. Such institutions include investment banks, hedge funds, large credit unions, insurance companies, and any other institutions that provide financial services.

Make CRA more relevant to diverse communities

The demographics of the US are changing rapidly; by the year 2042, 54% of all people in the country will be people of color. People of color have the highest rates of being unbanked and are suffering disproportionately from the foreclosure crisis. There is no doubt that our economy will suffer if such a large portion of residents are without adequate financial services. Recent research from the Federal Reserve Bank of San Francisco shows that Black homeowners were more than twice as likely as White borrowers to receive a high-cost, subprime loan, even after controlling for income and FICO scores.

In this context, Greenlining believes CRA should consider race and ethnicity during exams. Though race and ethnicity data is collected for home loans, it is not collected for business lending and currently, banks can get an "Outstanding" rating even when little to no home and business loans go to communities of color, or when no direct outreach is made to diverse communities.

As the fastest growing segment of the population, diverse communities will play an increasingly important role in our nation's renewed economic development and growth. By ending colorblind reporting, CRA can help to ensure these communities are provided with the fair access to capital and other financial tools needed to contribute to the country's future.

Increase public input in the examination process

Regulators should hold annual hearings that allow financial institutions to report how they are reaching all segments of the American economy. The regulators should also hold annual diversity hearings that allow the public to provide input on individual banks' CRA performance.

Make CRA ratings count

The CRA rating system is outdated and in need of substantial changes to make it relevant. Over half of the largest financial institutions receive an outstanding rating and generally none get less than satisfactory. (In fact, in a recent review of the ratings for all 36 financial institutions evaluated in a one-year period with over $5 billion in assets, 21 received an "outstanding" rating, "14 received a "satisfactory rating" and only 1 received a "needs to improve" rating.) The CRA rating system should be reformed so that a bank's overall performance in serving the economic and credit needs of communities are thoroughly examined.

Focus on the intent and spirit of the law

CRA has the potential of becoming a simple bureaucratic tool that counts points and does not necessarily reflect real efforts being made at extending financial services to the unbanked. CRA should be modernized to maintain the integrity of the act and to ensure that innovative and creative efforts at empowering consumers are recognized.

For example, banks are making more attempts to serve their local economies by making efforts to diversify their workforce and provide business contracts to local minority-owned vendors. They should receive CRA credit for this. Others are considering innovative wealth building tools and products for reaching the unbanked. These efforts should also be properly recognized in CRA exams.

CRA should direct investments to those areas that are most underserved and where financial institutions profit.

Currently a bank's assessment area includes the geographies in which the bank has its main office, its branches, and its deposit-taking ATM's. This system is increasingly outdated especially for financial institutions that do not rely on branches or ATMs.

A recent example with Goldman Sachs highlights the need to reform how assessment areas are defined. In order to save itself and take federal support Goldman Sachs registered as a bank on September 21, 2008. However, since Goldman only has a physical presence in New York City, it has been effectively allowed to redline California by not having any CRA commitment to a state from which they receive a large amount of their revenue.

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Myths vs. Facts: Scapegoating CRA on the Financial Crisis

Myth: CRA caused Bear Stearns, Lehman Brothers, and Merrill Lynch to fail.
Fact: CRA did not apply to these failed institutions. Had these companies been more closely regulated, they might still be around today.

Myth: The Community Reinvestment Act (CRA) caused the foreclosure crisis.
Fact: The majority of loans resulting in foreclosure were originated by non-CRA covered financial institutions. In fact, only about 25 percent of subprime loans were made by institutions covered by CRA.

Myth: Lending to low-income communities and communities of color caused this crisis.
Fact: It was greed and de-regulation on Wall Street that led to the crisis. Up to four-fifths of subprime loans were issued by financial institutions that operated with little or no federal regulatory oversight .

Myth: Excessive lending to undocumented immigrants led to the financial crisis.
Fact: Mortgages originated to undocumented immigrants (ITIN mortgages) have actually performed better than conventional loans. ITIN mortgages have a delinquency rate of 0.5% versus a 6.4% delinquency rate for all home loans[6].

Myth: CRA was a liberal-driven program designed to con banks into extending credit to unqualified minorities.
Fact: CRA has helped find banks new markets of credit worthy costumers that have led to profitable investments.

Myth: CRA has forced banks to lend to families that are under-qualified—and fines banks that don't comply.
Fact: CRA does not force lenders to make riskier loans. It requires regulated banks to provide loans to all qualified applicants regardless of geographical location and/or race. No bank has ever been fined for failure to comply with CRA.

Myth: The financial crisis was a result of too much regulation.
Fact: The most volatile sections of the mortgage business, including securitization, were almost completely unregulated. It is securitized mortgages that are now the hardest loans to modify, further adding to the financial crisis. (Securitization is conversion of pools of loans (such as mortgage loans) that are bought from lenders, into securities or bonds that are then sold to various investors.)

Myth: Bankers hate CRA.
Fact: Every large bank has now publicly stated that CRA did not cause the foreclosure crisis. As Richard Davis at US Bank has observed, "Community reinvestment is integral to our business because it helps ensure the success of every neighborhood we serve."

THE GREENLINING INSTITUTE

Greenlining is a multi-ethnic advocacy, research, leadership development, and public policy organization whose ultimate goal is to increase the role that low-income and minority Californians play in the civic arena in order to create equitable policies and improve quality of life for all communities.

Our mission is to empower communities of color and other disadvantaged groups through multi-ethnic economic and leadership development, civil rights and anti-redlining activities.

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