

**PRINCIPLES TO MODERNIZE THE COMMUNITY REINVESTMENT ACT:
HOW CRA CAN HELP LOW-INCOME LATINO FAMILIES BUILD WEALTH AND
SECURE THEIR FINANCIAL FUTURE**

Presented at

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Good morning. My name is Eric Rodriguez and I am Vice President of the Office of Research, Advocacy, and Legislation at the National Council of La Raza (NCLR). NCLR is the largest national Hispanic¹ civil rights and advocacy organization in the United States, dedicated to improving opportunities for Hispanic Americans. For more than 15 years I have been working on public policy and advocacy on behalf of Latinos, and I oversee work on a range of issues that matter to the community, from housing and jobs to health care. I would like to thank Chairman Gutierrez and Vice Ranking Member Hensarling for inviting me to share NCLR's perspective on the modernization of the Community Reinvestment Act (CRA).

For more than two decades, NCLR has promoted policies, programs, and practices that support sustainable Hispanic homeownership. NCLR conducts research and analysis on relevant public policy issues such as preserving and strengthening the CRA and the Home Ownership and Equity Protection Act (HOEPA), supporting strong fair housing and fair lending laws, and expanding access to affordable credit. In addition, NCLR is the only Hispanic-focused housing counseling intermediary certified by the U.S. Department of Housing and Urban Development (HUD). The NCLR Homeownership Network (NHN) provided first-time homebuyer and foreclosure prevention counseling to more than 50,000 families last year alone. NHN counselors are working closely with borrowers to ensure that they are prepared for homeownership and to help them avoid predatory scams. Through this effort, NCLR is working toward the advancement of Latino families, strengthening America by promoting affordable homeownership opportunities and ensuring that families facing foreclosure get the assistance they need.

Our subsidiary, the Raza Development Fund (RDF), is the nation's largest Hispanic community development financial institution (CDFI). Since 1999, RDF has provided \$400 million in financing to locally based development projects throughout the country. This work has substantively increased NCLR's institutional knowledge of how Latinos interact with the mortgage market, their credit and capital needs, and the impact of government regulation on financial services markets.

CRA is one of the most important tools the public has to ensure that neighborhoods and communities with low-income families have fair and affordable access to mainstream banking services, credit, and investments. The Act has helped to revitalize neighborhoods and enable nontraditional borrowers, including many Latinos, to gain services and benefit directly from investments made by large mainstream banks that might otherwise have left the community underserved. CRA has also been an important tool, albeit indirectly, in mitigating the effects of discrimination and disparate treatment of minorities, Latinos, and immigrants within mainstream financial markets; this social goal remains essential today.

That said, CRA is facing a serious challenge as its potency and effectiveness have waned in recent years, and some question its necessity and relevance in the current market. Therefore, we thank the committee for holding this important and timely hearing, and appreciate the tone and openness to gathering ideas on how to modernize this critical law.

¹ The terms "Hispanic" and "Latino" are used interchangeably by the U.S. Census Bureau and throughout this document to identify persons of Mexican, Puerto Rican, Cuban, Central and South American, Dominican, and Spanish descent; they may be of any race.

In my testimony today I will summarize the challenges facing CRA and its influence in communities of color, identify key lessons on what has made CRA successful in the past, and share a set of principles to guide the reshaping of CRA moving forward.

Community Reinvestment Act

Established in 1977, CRA requires that regulated depository institutions safely and soundly help serve the credit needs of communities where they conduct business.² The Act was established in response to widespread “redlining,” a practice that severely restricted credit from reaching minority and low-income communities. At the time, opponents argued that CRA goals and requirements would inhibit the growth of banks or cause them to engage in risky lending. In practice, regulators review financial institutions according to their size, require that lending and investment be conducted within the bounds of safety and soundness, and allow substantial flexibility in the range of activities considered in the determination of an institution’s rating. Over time, CRA has emerged as a critical investment and affordable lending tool, lauded by regulators, banking institutions, and advocates alike.

Over the more than three decades of its existence, CRA has served an important public interest in encouraging regulated banks to lend in minority and low-income communities. With increased regulatory attention during the 1990s, banks covered by CRA increased lending activity in low-income communities, increased the share of their loan portfolios with CRA-covered loans, and outpaced similar growth in lending to low- and moderate-income families among non-CRA-covered institutions.

CRA also helped to spur mainstream regulated financial institutions to innovate in ways that have been helpful to minority and low-income borrowers. CRA encourages banks and regulated financial institutions to engage nontraditional and low-income borrowers with the benefit of increasing understanding, experience, and information about how best to serve this market and potentially lower transaction costs associated with lending activity. CRA has also spurred regulated banks to establish and strengthen relationships with local community-based organizations (CBOs), which help advance banks’ goal of lending safely and affordably to low-income residents. CBOs also provide regulated financial institutions with information needed to tailor products to low-income residents, while providing support services that revitalize as well as stabilize neighborhoods and communities where banks do business. One important outcome of this activity and innovation is the creation of Community Development Corporations (CDCs) and CDFIs that have assisted in ensuring that capital and credit flow into low-income communities from regulated banks in ways that are safe and affordable. The original pilot program that led to NCLR’s Homeownership Network was created in large part due to CRA.

Despite these important outcomes, developments in the U.S. financial market over time have eroded the effectiveness of CRA. While overt “redlining” (i.e., refusing to lend to residents of low-income or minority neighborhoods) appears to be a thing of the past, research demonstrates

² CRA is intended to encourage banks and thrifts to help meet the credit needs of the communities in which they operate—including designated low- and moderate-income neighborhoods—consistent with safe and sound banking operations. CRA only applies to federally regulated banks and thrifts whose deposits are insured by the Federal Deposit Insurance Corporation (FDIC). To learn more, please go to: <http://www.ffiec.gov/CRA/>.

that policy and practice within mainstream mortgage and credit markets continue to exacerbate inequality and racial/ethnic discrimination. For example, policy and practice among regulated mainstream financial institutions to provide prime loans to only those individuals with a long and well-established credit history pushed many creditworthy young, foreign-born, minority, and low-income residents into subprime markets where exposure to predatory lending has been high. Automated underwriting practiced by mainstream regulated financial institutions is an innovation that has minimized arbitrary and potentially discriminatory lending decisions on the part of bank loan officers. But it also has meant higher costs for mainstream banking institutions to effectively serve nontraditional borrowers who do not fit neatly into the model. Oftentimes low-income families, female-headed households, immigrants, and borrowers of color require more time and create relatively more cost for an institution to accurately assess creditworthiness. This high cost has often resulted in credit rationing that effectively and unnecessarily pushes creditworthy nontraditional borrowers into subprime lending markets where predatory lending has thrived. In fact, a substantial share of subprime borrowers would have qualified for prime mortgages. At the same time, the subprime lending market grew exponentially and large lending institutions emerged that were not covered by CRA. This development created a new set of challenges for those seeking to ensure affordable and equitable access to credit for low-income and minority families.

Furthermore, regulators evaluate a depository institution's performance in certain geographic areas generally determined by the presence of physical branches and based on three key areas—service, investment, and lending.³ However, as technology has improved and regulations changed, many banks conduct business well beyond the walls of their branches.⁴ CRA-covered institutions have acquired non-covered affiliates and expanded their customer base through new delivery channels such as mortgage brokers and the Internet, thereby broadening their reach without a proportionate increase in CRA coverage. Finally, community leaders have raised concerns over “grade inflation,” questioning whether exams are sufficiently rigorous to hold banks accountable. In the last five years, fewer than 2% of CRA exams have resulted in “needs to improve” or “substantial noncompliance” ratings.⁵ As a result, covered institutions have less to strive for and fear from their CRA exam.

CRA's diminishing influence over the development and delivery of financial products has had a devastating impact on local communities. Demand for financial services has been growing, or at least holding steady, in most communities—especially among Latino, African American, and Asian households, which are expected to drive household growth through the year 2050. As

³ Service tests vary in scope depending on the size of the institution. For more information, see Comptroller of the Currency Administrator of National Banks, *Community Reinvestment Act Examination Procedures: Comptroller's Handbook*, CCE-CRA (Washington, DC: Comptroller of the Currency Administrator of National Banks, 1997, revised for web publication 1999), <http://www.occ.treas.gov/handbook/craep.pdf> (accessed April 13, 2010).

⁴ For a full discussion on how changes in regulations, such as the near repeal of Glass-Steagall, and industry consolidation have impacted the significance of CRA, see Liz Cohen and Rosalia Agresti, “Expanding the CRA to All Financial Institutions,” *Revisiting the CRA: Perspectives on the Future of the Community Reinvestment Act* (Boston and San Francisco: Federal Reserve Banks of Boston and San Francisco, 2009) 134–137 http://www.frbsf.org/publications/community/cra/expanding_cra_to_all_financial_institutions.pdf.

⁵ House Committee on Financial Services, Subcommittee on Housing and Community Opportunity, *Fair Housing Issues in the Gulf Coast in the Aftermath of Hurricanes Katrina and Rita*, 109th Cong., 2nd sess., 2006.

CRA-covered institutions serve fewer neighborhoods for all the reasons discussed above, they leave a vacuum that is quickly filled by providers of alternative forms of credit. Neighborhoods once served predominately by depository banks have been inundated by offers and services from mortgage brokers and finance companies, subprime credit card providers, payday lenders, and auto dealer financiers. Such companies have proved adept at breaking into neighborhoods underserved by CRA institutions. They have diversified their workforces, offered products that appeared attractive to unsophisticated customers, and marketed a guaranteed “yes”—tactics that banks have not employed consistently. Because these often unscrupulous providers are not covered by CRA, the overall public and social ends that the Act aims to address have become harder to reach.

And yet, those goals remain critically important to pursue within the current and future financial marketplace. To begin with, the last decade has experienced a marked growth and influx of immigrant workers into low- to moderate-income neighborhoods. Many of these residents are nontraditional borrowers who in many cases have short recorded credit histories or often no credit scores. Paradoxically, their “thin” credit files are often the product of highly sensible financial practices such as paying in cash, avoiding debt, and limiting their use of credit cards. In addition:

- **Bank accounts.** A recent report from the Federal Deposit Insurance Corporation (FDIC) found that approximately 19.3% of Hispanics and 21.7% of Blacks are unbanked, compared to only 3.3% of Whites.⁶ Numerous research reports have found that high fees and balance requirements are a leading reason for not choosing to have a bank account.
- **Credit cards.** Latino and African American consumers are nearly twice as likely as White consumers to pay interest rates higher than 20%.⁷ This figure becomes more troubling in light of the recession, where communities of color have been living with double-digit unemployment for more than a year. In this environment, many families are relying on credit cards to make ends meet, racking up substantial household debt.⁸
- **Small-dollar lending.** Similarly, many families have become dependent on small-dollar, short-term loans such as payday and car title loans. Many of these products have Annual Percentage Rates (APR) well over 300% and are structured in such a way that cash-strapped families will inevitably return for a new loan to pay off the original. A review of payday lenders in California revealed that they were heavily concentrated in Black and Hispanic neighborhoods, even after controlling for other explanatory variables.⁹

⁶ Federal Deposit Insurance Corporation, *FDIC National Survey of Unbanked and Underbanked Households* (Washington, DC: Federal Deposit Insurance Corporation, 2009) http://www.fdic.gov/householdsurvey/Full_Report.pdf (accessed April 13, 2010).

⁷ Jennifer Wheary and Tamara Draut, *Who Pays? The Winners and Losers of Credit Card Deregulation* (Washington, DC: Demos, August 2007) http://www.demos.org/pubs/whopays_web.pdf (accessed April 13, 2010).

⁸ Janis Bowdler, *Survival Spending: The Role of Credit Cards in Hispanic Households* (Washington, DC: National Council of La Raza, 2010) <http://www.nclr.org/content/publications/detail/61318/> (accessed April 13, 2010).

⁹ Wei Li et al., *Predatory Profiling: The Role of Race and Ethnicity in the Location of Payday Lenders in California* (Washington, DC: Center for Responsible Lending, 2009) (accessed April 13, 2010).

- **Car loans.** According to one study, 57% of Hispanic customers who financed their car through the auto or dealer finance company were charged an unwarranted markup, compared to 40.2% of White customers. The average markup for Hispanic customers was \$715, compared to \$464 for White customers.¹⁰
- **Mortgages.** Latinos are 30% more likely than Whites to receive a high-cost loan when purchasing their home. Research shows that nontraditional mortgage products such as Option Adjustable Rate Mortgages (Option ARMs)¹¹ and Interest-Only Mortgages are disproportionately concentrated among minority borrowers; Latinos are more than twice as likely as Whites to receive an Option ARM. Some lenders have heavily marketed Stated-Income loans to Latino families rather than take the time to verify their cash income and savings.

In view of the data above, it should be no surprise that the U.S. continues to maintain a persistent and staggering wealth gap between minority and White households with implications for the socioeconomic development of the nation. Taken together, these facts warrant continued and more effective government intervention to correct and ameliorate disparities in financial markets.

Core Elements of Success in CRA

While imperfect, CRA has many of the right mechanisms in place to become a strong force for good once again. Before discussing ways to modernize CRA, it is helpful to review what has made the Act successful, such as the following:

- **Flexibility.** CRA is far less intrusive than some alternative approaches to achieving similar goals of fair distribution of credit, such as mandating levels of investment in credit-starved areas or prescriptive lending requirements or product offerings. CRA represents a moderate approach that does not mandate specifics or require absolute levels of lending. Instead, it provides lenders and communities with substantial flexibility, consistent with safety and soundness, in meeting the goals of the Act as they relate to localities.
- **Leverages federal/state/local community investments.** CRA has not required government spending; instead, it leverages private investment toward public goals and has helped to leverage and complement the efforts of other federal agencies such as HUD and the Treasury.

¹⁰ Mark Cohen, “Imperfect Competition in Auto Lending: Subjective Markup, Racial Disparity, and Class Action Litigation,” *Vanderbilt Law and Economics Research Paper* No. 07-01 (December 14, 2006) <http://ssrn.com/abstract=951827> (accessed April 13, 2010).

¹¹ Option ARMs are nontraditional home loan products where a borrower is able to choose the payment they wish to make month to month. Typically borrowers are offered four payment options—a minimum payment, an interest-only payment, a payment that if made consistently would pay off the home in the traditional 30-year timeframe (known as “fully-amortizing”), and a payment that if made consistently would pay off the home in 15 years. Some originators abused this product by qualifying families for only the lowest payment. In this scenario, families are unknowingly adding a balance to their mortgage each month, since their payments do not even cover the interest expense. When the mortgage reaches 115% of value, the monthly payment is adjusted to reflect the higher debt.

- **Coverage.** CRA was its strongest when the majority of lenders and service areas were covered by the CRA assessments, leveling the playing field and widely encouraging investments in, as well as competition for, low-income borrowers.
- **Community engagement.** When financial institutions collaborate with community leaders to develop their commitments and compliance strategy, the result has usually been mutually beneficial. Banks can ensure that their CRA activities are responsive to local credit, banking, and development needs and that the community benefits from an open dialogue and the ability to hold banks accountable.
- **Meaningful measurements.** The Act works best when there is true competition for business in underserved communities and across assessment areas. Similarly, CRA ratings are most impactful when exams take into consideration the complete needs of the assessment area and corresponding performance, rather than serving as a mere cursory review.

Principles for Reform

In the face of the most devastating recession in generations, brought into being in large part due to irresponsible lending practices of institutions not covered by CRA, now is the right time to expand the coverage, influence, and scope of the Act. While some detractors continue to prop up “straw man” arguments to blame CRA mortgages as the impetus for the financial crisis, this myth has been soundly debunked. Policymakers must now shift their focus to aligning CRA with modern banking systems, rules, and practices. Moreover, CRA is a powerful investment tool that should be leveraged to help the national economy to recover. As it stands, banks have restricted credit at a time when economically hard-hit neighborhoods—many of which are predominately minority or low-income communities—are struggling to access capital.

In considering how to modernize CRA, NCLR has two primary goals: 1) to preserve and expand the aspects of CRA which encourage product innovation, lending, and services that are critical to helping low-income Latino families build wealth and 2) to solidify incentives to direct capital toward community and economic development projects that may not otherwise get served. NCLR offers the following eight principles on which to base CRA reform:

- **All institutions that provide consumer financial services and avail themselves of federal support of any kind must be covered by CRA.** In the wake of a near collapse of the national financial system, companies of all categories with exposure to consumer debt in the form of mortgages, auto loans, credit cards, or securities backed by these debt instruments, sought the assistance of the federal government to prevent their complete failure. Mergers were arranged with federal subsidies, federal investments were made, and new companies had access to the discount window at the Federal Reserve.¹² In exchange for having access to federal support in any form—investments, insurance, subsidy, credit, or other forms—financial institutions should be obligated to participate in the furthering of the public goals of CRA. In addition, covered institutions should not be

¹² See “Expanding the CRA.”

allowed to skirt responsibilities by simply acquiring a non-covered entity. At minimum, coverage must be expanded to include an institution's non-bank affiliates and their subsidiaries. Other companies, such as mortgage finance companies, insurance companies, securities firms, and investment banks should also be included under the CRA umbrella.

- **Covered institutions must be assessed in their true geographic footprint.** A bank or company must be assessed in all of the geographic areas in which it provides consumer financial services. No longer should banks be able to provide high-quality CRA products in one area, but restrict them in non-assessment areas. This becomes critically important as technology continues to evolve and new delivery channels are developed, each of which change the way that financial institutions interact with communities and consumers.
- **CRA exams and ratings must incorporate the input of local communities.** As CRA exams have become increasingly routine, local leaders have had fewer opportunities to weigh in on banks' performance or collaborate on improvements to services and products. With CRA's flexibility should come an obligation to meet on a regular basis with CBOs and community leaders who can provide feedback on the needs of the community, as well as successful outreach and product design strategies. Implementation has worked best when CRA-covered institutions and stakeholders work jointly to develop a strategic plan to invest in service delivery, community and economic development, and lending. In addition, community stakeholders need a mechanism to provide input on a company's exam. Doing so allows organizations to communicate their positive and negative experiences with regulators and ensures that banks are being held accountable during the review process.
- **CRA-covered institutions should spur innovative and responsible investments and lending in low- and moderate-income communities, establishing best practices for the rest of the market.** Banks and finance companies should be rewarded for taking measured risks to experiment with new delivery channels, underwriting criteria, product development, and community projects. For example, creating basic startup checking accounts for unbanked individuals, developing underwriting criteria for individuals with nontraditional credit, creating alternatives to payday loans, and partnering with qualified nonprofits to provide financial or housing counseling to vulnerable clients are all factors that should count toward favorable CRA ratings.
- **Exams and rating procedures must be transparent and open to the public.** While flexibility should be preserved, compliance should be gauged using simple, measurable standards such as the number and percentage of qualifying loans, grants, and other investments (sales or purchases of qualifying tax credits, for example). In addition, more data are required to hold accountable banks and other institutions that should be covered, such as insurance companies and securities firms. Communities rely on federally collected and publicly available data to assess the credit needs of their community and spot any trends that may be a cause for concern.

- **Exams must incorporate the institution’s fair lending record.** In addition to reviewing a covered lender’s Home Mortgage Disclosure Act data, examiners should also review the degree to which similarly priced loans are offered across neighborhoods and compared to the bank’s peers, including mortgage finance companies. In particular, regulators should examine lending and services to minority borrowers and neighborhoods and be on careful lookout for discriminatory trends.
- **The practice of grade inflation has no place in sound and meaningful CRA enforcement.** CRA can only be as effective as its implementation allows. Policymakers should raise the standard required for an “outstanding” rating and regulators should provide clear explanations of their methodology, loan types examined, and the results of fair lending reviews during exams. For bank holding companies that operate lending affiliates regulated by different federal and state agencies, regulators must use a holistic approach by taking into consideration the affiliate’s product mix, marketing efforts, delivery channels, and pricing models and decisions of all lending entities.
- **Investments in communities hard-hit by the economic crisis should be rewarded.** Banking services are vital to helping areas hard-hit by recession. Similar to the expansion of CRA to disaster areas in 2005, credit should be given for investing, serving, and extending credit in neighborhoods rocked by high unemployment and foreclosures. For example, partnering with and funding community-based organizations to reach out to delinquent homeowners, creating a flexible mortgage loan for the purchase of short-sale and real estate-owned properties, investing in affordable housing and community institutions, and taking steps to minimize foreclosures and help communities rebound from the recession.

Thank you. I would be happy to answer any questions.