Consumer Federation of America

Testimony of

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On

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Thank you for the opportunity to testify today on modernizing the Community Reinvestment Act (CRA). My name is Barry Zigas. I am Director of Housing Policy at the Consumer Federation of America (CFA). CFA represents 280 state and local consumer organizations and provides policy development and analysis services on a wide range of consumer issues, including consumer finance, especially as they affect low and moderate income consumers.

The CRA has been an important element in assuring that all households have access to safe and affordable credit. When it was originally adopted in 1977, the notion that all lending institutions that take deposits from communities should have an obligation to provide those communities with a full range of credit services was not universally accepted. But today, after many years of work by community organizations, regulators, lenders and others, this should not be a controversial position. Indeed, while *lack* of credit in low and moderate income neighborhoods, and communities of color, was the major concern when CRA was debated and adopted, since then we have learned once again that it is possible for communities to suffer from *too much* credit. The flood of irresponsible, expensive and unstable credit that was offered at the height of the mortgage boom in the last decade exemplifies the notion that bad money will drive out good money in the absence of sensible and enforced regulation.

We agree with the consensus opinion of every federal financial regulator that CRA was not a significant contributor to this flood of credit. Indeed, we believe that lenders that were trying in good faith to offer responsible and stable products were out-sold by less scrupulous capital sources. At the same time, some CRA-regulated institutions took advantage of loopholes in CRA coverage to join this trend through acquisitions and affiliations that enabled them to profit from lending practices that would not have been countenanced under a CRA review that took into account the totality of the institution's business.

The collapse of these alternative financing channels is an excellent opportunity to rethink and modernize the CRA. We thank you and your colleagues for holding these hearings and soliciting comments from the public as you consider how to go about this. In addition to regulatory modernization, we believe that legislative reforms also are necessary. I would like to offer a few broad suggestions for areas that we think are in immediate need of reform.

Assessment Areas

The banking world of 1977 was very different than the one in which we live today. CRA was conceived to require what were generally *local* institutions that raised capital from deposits to reinvest it to meet the credit needs of their entire community. There was plentiful evidence at the time that conventional institutions used stereotypes and standards that excluded some communities and residents within those communities from having access to credit. The definition of the service area against which the CRA would be judged therefore was primarily focused on the areas from which lenders drew those deposits.

Such a narrow conception of a lender's service area is no longer sensible. Large parts of the country today are served by lenders operating in many areas within a state, and in many different states. Deposits can be drawn from the entire country. Yet service areas for CRA compliance are narrowly drawn and fail to reflect the scope of market penetration many of these lenders actually enjoy. CRA reviews and evaluations consequently reflect an incomplete and sometimes haphazard picture of a lender's actual marketplace and footprint. This is bad for communities and for lenders. The former can be left out of a review entirely even when an institution has a large presence, directly or through affiliates, frustrating CRA's core purpose. Lenders can be faced with multiple reviews over many areas that do not necessarily reflect the full scope of their business. These reviews can be time consuming and very costly, and yield only a fragmentary picture of the lender's business and success at meeting the credit needs of the communities in which it operates. By restricting reviews to those areas where banks have branches CRA necessarily misses many areas that are served by lenders through intermediaries, brokers and others. The emergence of internet banking, industrial banks that operate widely but have branches only in one location, and customer service through ATMs means that consumers can be located in areas without a branch but still be interacting in many of the same ways as those located near one. This shift in the banking landscape means that actual coverage of banks' business has shrunk. One estimate states that the number of home loans covered by CRA exams actually has shrunk by as much as 25 percent since CRA's inception.[1]

CRA regulatory oversight should be designed to capture most, if not all, of a lender's activities across whatever geographies it operates in. This will require a significant rethinking of the means regulators use to assess performance. Credit needs in all localities are not the same in degree or type. Applying a "one size fits all" approach could distort incentives for lenders to emphasize certain types of lending regardless of their appropriateness in different circumstances. Wider use of needs assessments generated by both lenders and regulators against which CRA performance can be measured is one possible solution to this problem. Another is more standardized protocols for regulators that will reduce uncertainty for lenders in the review of performance against such performance plans. The Federal Housing Finance Agency (FHFA) recently has proposed a rulemaking for a CRA-like "duty to serve" by Fannie Mae and Freddie Mac that includes such an advance assessment and plan for action against which performance can more meaningfully be measured. While these secondary market entities differ significantly from CRA-covered lenders, the model is worth closer examination.

Another way that regulators could encourage investments in areas that are outside the scope of larger institutions today is to identify them in advance of reviews and consider activities that benefit them and demonstrably increase the flow of credit to them for greater weight in CRA exams. This more strategic approach would enable regulators to better match their reviews to expected outcomes, and enable lenders to clearly and accountably describe how they plan to serve the communities in which they operate.

Coverage of Affiliates

Another change in the banking landscape since 1977 has been the merger of many institutions into a smaller number of very large ones, and the development of affiliate relationships through which one lender may operate multiple lines of business in multiple geographies. Yet CRA currently does not facilitate coverage of the total book of such lenders' business. Instead, these multiple entities may have separate CRA reviews, by multiple regulators, under different terms depending on their size, or no CRA review at all. Yet from a business point of view, all of these entities are the means through which the parent company carries out its business. Wells Fargo, for instance, is listed in Home Mortgage Disclosure

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[1] Ren Essene of the Federal Reserve Bank of Boston and William C. Apgar of the Joint Center for Housing Studies, Harvard University, *The 30th Anniversary of the CRA: Restructuring the CRA to Address the Mortgage Finance Revolution*, in Revisiting the CRA: Perspectives on the Future of the CRA, eds. Prabal Chakrabarti et al., A Joint Publication of the Federal Reserve Banks of Boston and San Francisco, 2009

Act (HMDA) data as the owner of more than 200 separate affiliated lending institutions. It is virtually impossible to form a clear picture of any lender's performance in meeting the CRA's intent while these subsidiary entities are not consolidated in the review.

A modernized CRA should consider taking affiliate activities into account when assessing a covered institution's activities.

Assessment Grades

The current limited set of choices for assessing CRA performance has led to a clustering among lenders of "satisfactory" and "outstanding" ratings that have robbed them of much of their meaning. Regulators should develop a more nuanced set of assessment grades. These would permit regulators to take into account more circumstances and outcomes and encourage or discourage activities that might otherwise be masked in the larger and less descriptive ratings that are available today. One possibility is to add a "high" and "low" rating to the current "Satisfactory." Another would be to separately assess different major categories. In addition to measuring the quantity of loans, for instance, a review might more clearly assess the suitability of the loans available given the circumstances of the community; the process through which loans are made available; the range of credit opportunities and whether sustainable, innovative products are offered; their likely relative impact on the community in which they are made; and so on.

We also recommend that CRA reviews examine the quality and suitability of lending carried out in service areas and use such assessments in assigning a performance grade. Refund anticipation loans, payday loans and other forms of abusive and high cost credit should not be rewarded with high CRA performance grades. Conversely, wide distribution and marketing of stable, responsible lending products that meet the needs of community residents should be rewarded and encouraged. Reviews may have to be expanded to examine both affiliate activities and funding activities through which covered lenders provide capital, but not direct loans, that supports abusive lending practices in their footprints.

Deposit and Savings Services

CRA's major focus is on lenders' performance in extending credit in the communities where they are located. But the prevalence of expensive, nontraditional banking services in low and moderate income and minority communities is testament to the difficulty many households have in obtaining and using safe and affordable savings and deposit products. CRA exams should take into account both the quality and quantity of these services offered by covered lenders. These can be taken into account now through the Service Test, and we encourage more and closer examination through it. Legislation may be necessary to fully enable regulatory oversight in these areas, but we believe strongly that consumers need access to these services and are in many cases not receiving them.

In addition, we note that many consumers can be saddled with very high transaction costs for even standard deposit services. The recent regulatory changes requiring that lenders solicit an "opt in" from consumers to provide overdraft loans for debit and ATM transactions is a sobering illustration of this problem. A recent CFA survey of bank overdraft fee policies and schedules documents that the burden still falls on consumers to avoid usurious charges for overdraft services, for instance. Some lenders, like Bank of America, USAA and Citigroup have decided not to offer an opt-in feature for consumers, and we applaud their leadership. Others, however, have been soliciting consumers with offers for such services that come with high costs, even when the overdraft is small and the consumer may be unaware of having triggered it. I would like to include a copy of the press releases summarizing CFA's recent survey of overdraft and opt-in policies for the record. We urge you to consider taking such policies into account and lowering overall ratings for lenders that consistently charge high fees and saddle consumers with repeating charges that generate usurious interest rates on loans that consumers did not specifically seek or apply for.

Enforcement Mechanisms

The principal punishment for poor CRA performance is the possibility of denial or delay of applications for mergers and acquisitions. While this has been a powerful incentive for lenders to seek high CRA ratings in the past, its power has diminished over time. The very largest lenders with the most coverage are unlikely to seek a significant number of these actions in the future. Regulators should consider using other means to reward good CRA behavior and punish records that lag the norm. One possibility is to charge those with poor CRA ratings higher regulatory assessments or premiums for federal deposit insurance. Both of these are part of the bundle of benefits that regulated institutions receive. It is not inappropriate to differentiate the cost of such benefits based on lenders' willingness and ability to meet their obligations to the communities they serve.

We also endorse recommendations from the National Community Reinvestment Coalition (NCRC) to boost the rigor of the fair lending reviews that probe for evidence of illegal and discriminatory lending. Fair lending reports on CRA exams must be detailed explanations of the fair lending tests used instead of the one or two sentences currently on most CRA exams. In addition, regulators should consider expanding the concept of illegal and discriminatory lending to include unsafe and unsound lending. Banks have failed CRA exams because they made or financed unsafe loans; the fair lending review must routinely indicate whether the review found evidence of unsafe and unsound loans.

Modernization of CRA regulation is a critical part of recalibrating how consumer banking works in the aftermath of the financial crisis. We appreciate the opportunity to share our views through this hearing and look forward to working with you as you develop your policies.