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Statement of the Shadow Financial Regulatory Committee

on

PROPOSED REVISIONS TO COMMUNITY REINVESTMENT REGULATIONS

February 14, 1994

Background

To eliminate invidious discrimination in the granting of credit, public policy follows a two-pronged approach. The Equal Credit Opportunity Act (ECOA), applies to all lenders and prohibits discrimination based on factors such as the borrower's race, gender, national origin, marital status, and age. This Act addresses permissible individual lender behavior when considering applications for loans. The Committee fully supports the intent and thrust of ECOA.

The second prong is the Community Reinvestment Act (CRA). CRA addresses presumed de facto discrimination by banks and thrift institutions against borrowers that results from failure to extend credit to residents of low- and moderate-income communities, areas often heavily populated by minorities.

Enforcement of CRA has failed to resolve satisfactorily the concerns of community activists. These critics complain that there are inconsistencies in CRA enforcement and that present regulations overemphasize process and underemphasize performance. Bankers complain that CRA is unclear, examination standards are applied inconsistently, and excessive paperwork is required, resulting in fewer loans, services, and investments. In response to criticisms of CRA, the federal banking agencies have proposed changes. For reasons given below, however, the Committee concludes that CRA should be repealed.

Proposed Changes

The proposed new regulations would require banks and thrifts to report a large amount of data on the number and amount of loan applications, denials, approvals, and purchases by census tract for ten kinds of loans. These include loans to small businesses (divided into four groups by company sales volume), consumer loans, small farm loans, and four groups of residential real estate loans. Independent depository institutions with less than $250 million in assets could choose not to report the above loan data. Instead, they would be evaluated according to their overall loan-to-deposit ratios, the degree to which they make their loans in their service area, their loan mix (across product lines and income levels of borrowers), their "fair lending" record, and community complaints. Wholesale and limited-purpose banks would be required to invest in community and economic development activities, which may include grants to organizations that promote these activities.

The proposed regulations include extensive discussions of how effective lending territories might be defined, what sort of loans or other services might count as benefiting low-and moderate-income areas and what types of investments would be counted as meeting an institution's CRA obligations (e.g., donation or sale on favorable terms of branches to minority- or women-owned institutions).

Banks and thrifts would be graded according to how well they appear to serve their effective lending territories. Each institution's market share of the ten designated loan categories in the low- and moderate-income communities it services would be compared to its share of such loans in its other service areas and to the distribution of loans by other insured depository institutions. A bank or thrift with "poor" ratios might offset this by making other types of contributions to community activities and groups. An institution's CRA evaluation would be (as it is now) an important and often controlling factor in the banking agencies' review of its applications to establish or close a branch, acquire another institution, etc. Institutions with less than satisfactory ratings would be examined more frequently and might be penalized directly.

Recommendation

The Committee believes that, unlike ECOA, CRA is unnecessary. It is based on the faulty economic premise that funds raised by depository institutions should be employed first in the local communities from which they

were generated, rather than where they can be most efficiently invested.

There is little evidence that CRA has had an appreciable impact on credit flows to disadvantaged communities and persons. Rather, it has evolved into a costly and ineffective credit allocation scheme that tends to benefit primarily those vocal special-interest groups capable of extracting concessions from lenders. Past experience has shown credit allocation programs to be expensive to administer, difficult to target, virtually impossible to monitor, and ineffective in helping targeted borrowers.

The complexity of the proposed regulations outlined above demonstrates the inherent difficulty of administering a program that substitutes regulatory directives for individual market decisions by lenders. In attempting to avoid imposing rigid guidelines and rules on financial institutions, federal regulatory agencies have proposed rules that are complex, often subjective, and potentially very costly for larger institutions. Lower direct costs would be imposed on smaller institutions. However, if CRA were truly an anti-discrimination statute rather than a credit-allocation scheme, there would be no justification in exempting independent banks with assets under $250 million from the reporting requirements applicable to larger banks.

The Committee believes that the problems of inner cities are serious; they are, however, at most only slightly due to a shortage of credit to qualified households and businesses. Programs are needed that directly target these problems, especially joblessness, crime, schooling and inadequate economic development. These programs should be expressly funded on federal, state, and local budgets, so that taxpayers can monitor them and determine returns for effort and resources expended. For the reasons enumerated, the Committee concludes that CRA should be repealed.

At the same time, ECOA should be vigorously enforced. The regulatory agencies should foster a sympathetic environment where individuals who believe they have been unfairly discriminated against can seek agency help. The agencies should investigate all consumer complaints carefully and quickly. Lenders who discriminate invidiously should be prosecuted.