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Statement of the Shadow Financial Regulatory Committee

on

Proposed Community Reinvestment Act Regulations

December 12, 1994

On September 26, 1994 the federal banking regulatory agencies proposed new Community Reinvestment Act Regulations, 12 CFR Parts 25, 228, 345 and 563e. The proposal implements a 1993 Presidential request to "replace paperwork and uncertainty with greater performance, clarity, and objectivity." The proposed regulations introduce new reporting requirements and three tests for compliance under the Act. Reporting coverage, while supposedly streamlined, was actually expanded to include loans to small businesses owned by minorities and women. The tests consist of a lending test, an investment test, and a service test.

(1) The lending test focuses on ratios of lending activity in a "geography," particularly the ratios of loans to high-income borrowers versus low- and moderate-income borrowers, and an unspecified, unclear comparison of these ratios with those of other institutions.

(2) The investment test turns on "qualified" investments in various kinds of business agencies, foundations, and institutions involved in community development, including grants to such entities that presumably would be compared with unspecified norms.

(3) The service test requires the evaluation of an institution's record of providing services through branches, ATMs, and "alternative systems" that might limit or expand service to low- and moderate-income "geographies" and persons.

What began in 1977 as a Congressional response to allegations that depository institutions were redlining neighborhoods undergoing change has grown to more

detailed and extensive reporting requirements. The agencies charged with enforcing and evaluating these requirements have created bureaucratic structures involving extensive costs in agency personnel, reporting costs to regulated institutions, and even micromanagement of financial institutions. The proposed amendments are likely to increase these costs significantly, with few if any additional benefits to the communities that are supposed to be helped.

The Committee continues to question the value of the Community Reinvestment Act itself. The Act is predicated on the undemonstrated assumption that the banking and thrift industry has failed to deliver adequate credit services in certain urban neighborhoods, and the belief that significant improvement can result from supervisory pressures. No credible evidence has been published demonstrating the validity of the assumed credit failure. Financial market evolution over the past 25 years has eroded materially any market monopoly advantage that banks and thrifts once might have enjoyed. Other providers of credit, such as mortgage companies, credit unions, and finance companies, continue to increase their share of the market at the expense of banks and thrifts. In addition, recently enacted legislative changes that allow interstate banking and encourage intrastate branching should speed entry into any markets that might presently be inadequately served.

The proposed changes will not reduce the compliance burden on depository institutions, as was requested by the President. Like truth-in-lending, CRA has taken on a life of its own, resulting in ever increasing costs and regulatory micromanagement. Moreover, the Committee believes that the Equal Credit Opportunity Act and the Fair Housing Act adequately protect the public from impermissible lending discrimination.

In addition, the Committee deplores the cynical legislative strategy of the banking and thrift industries in suggesting that the Community Reinvestment Act be extended to credit unions, mutual funds and other competitors -- a strategy intended only to bring in more opposition to CRA itself. Congress should reassess the Community Reinvestment Act, including its need, effectiveness and cost, especially in view of the changes in financial markets that have occurred over the past 20 years. We believe this reassessment will lead the Congress to conclude, as did the Committee in its Statement Number 105 (February 14, 1994), that the Community Reinvestment Act should be repealed.