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The Community Reinvestment Act: New Standards Provide New Hope

Cover Page Footnote

The author thanks Professor Carl Felsenfeld, and journal editors Rachel Simon, Lee Rudy and Bernard Daskal for their helpful comments and suggestions; and Eleanor Balducci for support.

THE COMMUNITY REINVESTMENT ACT: NEW STANDARDS PROVIDE NEW HOPE

E. L. Baldinucci*

If we are to keep our system secure and our society stable, we must all begin to work where all of us work best—and that is in the communities where we all live.

Lyndon B. Johnson, August, 1964

Introduction

In 1989, Silfrido Rias and Edwin B. Canaan, two Dominican Republic trained lawyers, decided to start a business in the Washington Heights section of Manhattan.¹ The partners came across one major stumbling block—access to capital.² Lacking a credit history, they were forced to finance their project by gathering capital from relatives, credit cards, an informal revolving loan fund financed by other immigrants and, eventually, a loan shark that charged six percent a week on a \$10,000 loan.³

Mr. Frias' and Mr. Canaan's story is not unusual in low- and moderate-income neighborhoods nationwide. The lack of credit and banking services in inner city communities traditionally has helped perpetuate urban poverty⁴ and impede economic improvement.⁵ With this backdrop of continuing economic stagnation,

* The author thanks Professor Carl Felsenfeld, and journal editors Rachel Simon, Lee Rudy and Bernard Daskal for their helpful comments and suggestions; and Eleanor Baldinucci for her support.

1. Matthew Purdy & Joe Sexton, *Short of Banking Services, The Poor are Improving*, N.Y. TIMES, Sept. 11, 1995, at A1.

2. *Id.*

3. *Id.*

4. Peter Dreier, *America's Urban Crisis: Symptoms, Causes, Solutions*, 71 N.C. L. REV. 1351, 1363-64 (1993). The author notes that the government's official poverty line is defined by a family of four surviving on an income of less than \$13,924. Using that figure, forty-three percent of America's poor were living in inner cities by 1989. The author also notes that there are some who feel that these numbers are based on outdated data and that they do not reflect the true extent of inner city poverty.

5. Community reinvestment was a major part of President Clinton's economic platform in 1992. See GOV. BILL CLINTON & SEN. AL GORE, PUTTING PEOPLE FIRST: HOW WE CAN ALL CHANGE AMERICA 11-12 (1992). See also Peter P. Pitegoff, *Urban Revitalization and Community: Finance: An Introduction*, 27 U. MICH. J.L. REF. 613, 614-15 (1994) (discussing the acknowledgment by liberal and conservative urban critics that economic development is of fundamental importance in rebuilding distressed cities).

Congress enacted the Community Reinvestment Act (CRA) in 1977.⁶

The CRA requires federal banking regulators to consider a depository institution's⁷ record of meeting the credit needs of the local communities in which it is chartered⁸ when that depository institution seeks to expand or merge with another institution.⁹ Of course, the CRA is not the sole prerequisite by which a bank is allowed to merge with or acquire another institution; rather the federal supervisory agency must "take [the bank's] record into account" when evaluating its application.¹⁰ The CRA is controversial legislation. Banking trade groups have fought the law since its inception.¹¹ They argue that it will lead to government mandated credit allocation and that its compliance burden is too high.¹² As a result, some members of Congress propose to revoke the law, or to curtail substantially its effectiveness.¹³ On the other hand, com-

6. 12 U.S.C. §§ 2901-07 (1994). At the CRA proposal hearings, Senator Proxmire stated that "Government through tax revenues cannot and should not provide more than a limited part of the capital required for local housing and economic development needs. Financial institutions in our free economic system must play the leading role." See *Community Credit Needs: Hearings on S. 406 Before the Senate Comm. on Banking, Housing, and Urban Affairs*, 95th Cong., 1st Sess. 1 (1977) [hereinafter *Hearings*] (opening statement of Sen. William Proxmire).

7. 12 U.S.C. § 2903(a). The Act covers "regulated financial institution[s]," 12 U.S.C. § 2902(2), including insured national banks, state banks and savings associations. 12 U.S.C. § 1813 (a)-(1)-(4). For instance, credit unions have not been subject to CRA regulation.

8. See *infra* note 23. Because of concern that the law would force bad business decisions, Congress was careful to require that banks only take action within "the safe and sound operation of such institutions." 12 U.S.C. § 2901(b).

9. 12 U.S.C. § 2902(3)(E). The following applications require the federal agency responsible to review an institution's CRA record: for a national bank or federal savings and loan charter; for deposit insurance for a newly chartered state bank, savings and loan, or similar institution; for the establishment of a domestic branch; for relocation of a home office or branch; for mergers, consolidations, asset acquisitions, or liability assumptions that otherwise require regulatory approval; and for the acquisition of shares in, or assets of, a regulated institution that would otherwise require regulatory approval. See § 2902(3).

10. 12 U.S.C. § 2903.

11. See statement of Sen. Morgan: "If bills of this nature are pushed to their ultimate conclusion, then the day will come when a financial institution may be forced to make an unsound loan in a specific location in order to meet its quota of loans in a given locality." 123 CONG. REC. 17,628 (1977).

12. See Linda Corman, *Study Finds Documentation Biggest Factor in CRS Rating*, AM BANKER, June 3, 1991, at 7 (discussing the ability of large banks to obtain positive CRA ratings because of the extra resources available to document their activity); see also *infra* note 43 (defining credit allocation).

13. Congressional members have introduced a number of bills meant to undercut the CRA. See, e.g., H.R. 1699, 104th Cong., 1st Sess. (1995); H.R. 1362, 104th Cong., 1st Sess. (1995); H.R. 1211, 104th Cong., 1st Sess. (1995); H.R. 1019, 104th Cong., 1st

munity groups that support the premise of the law complain of weak federal regulatory agency enforcement.¹⁴ These criticisms are enjoying a renewed fervor in large part because of the recent flurry of mergers and acquisitions in the banking industry.¹⁵

This Comment reviews the history of the CRA and proposes solutions for the controversies surrounding both the merits of its underlying rationale and the means by which it is implemented. It argues that Congress should allow the recently issued federal supervisory agencies' regulations¹⁶ time to take effect before proposing any changes that would restrict the CRA's effectiveness.¹⁷ Further, when changes are made, the emphasis should be not on curtailing the CRA, but on extending its scope to include non-bank financial institutions.¹⁸

Part I chronicles the CRA from its adoption to its present status, including its revision under the Financial Institutions Reform Recovery and Enforcement Act of 1989 (FIRREA).¹⁹ Part II reviews the major criticisms of the CRA's supporters and detractors. Part III introduces the recent regulations issued by the regulatory agencies responsible for enforcing the CRA and the Congressional response to those regulations.²⁰ Part IV concludes that the CRA can

Sess. (1995); H.R. 317, 104th Cong., 1st Sess. (1995); H.R. 1858, 104th Cong., 1st Sess. (1995); H.R. 2520, 104th Cong., 1st Sess. (1995); S. 650, 104th Cong., 1st Sess. §§ 131-135 (1995).

14. Matthew Lee, executive director of the Bronx-based Inner City Press/Community on the Move and Fordham Law student, referred to the Federal Reserve Board's recent approval of Chemical Bank's acquisition of Chase Manhattan Bank as "overly bank-friendly." Jaret Seiberg, *Activists Hammer Fed for Approving Megamerger in Advance of CRA Report*, AM. BANKER, Jan. 10, 1996, at 2.

15. See Purdy & Sexton, *supra* note 1, at A1, B6 (discussing the Chemical Bank and Chase Manhattan Bank merger as emblematic of a larger trend in the banking industry).

16. See *infra* note 20 (listing the federal agencies responsible for enforcing the CRA).

17. All regulated institutions will be evaluated completely under the new regulations as of July 1, 1997. However, there are certain data collection and reporting requirements that are effective January 1, 1996 and January 1, 1997. Omer S.J. Williams & Jay L. Gracin, *New Standards for CRA Obligations*, N.Y. L.J., Aug. 14, 1995, at 5.

18. See *infra* Part IV.B (recommending that the CRA be expanded to include mortgage lending institutions and credit unions).

19. See Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, § 1212, Stat. 183, 526-27 (amending 12 U.S.C. § 2906).

20. There are four federal agencies responsible for enforcing the CRA. The Federal Reserve Board of Governors (the Fed) oversees state chartered banks that are members of the Federal Reserve System; the Federal Deposit Insurance Corporation (FDIC) regulates all state chartered banks and savings banks that are not part of the Federal Reserve System but are insured by the FDIC; The Office of the Comptroller of the Currency is responsible for national banks; and, the Office of Thrift Supervision

be a more effective legislative response to the lack of banking services in poorer inner city communities if the recent agencies' regulations are allowed to take effect and if careful steps are taken to extend the CRA to non-bank financial institutions.

I. The Community Reinvestment Act

The CRA departs from the traditional view that a bank's only responsibilities are to pursue monetary gain and preserve financial stability.²¹ Ordinarily, bank customers have no knowledge or control over the use or application of their deposits. As one commentator noted, banks are free to "support national or international enterprises engaging in discriminatory practices, companies polluting the environment, or even dictatorial governments."²² The CRA, however, places a continuing, affirmative obligation on banks to meet the credit needs of their communities—including low- and moderate-income neighborhoods—by providing appropriate credit needs and deposit services.²³

Federal regulators have found it difficult, because of the CRA's vague language, to maximize the potential of the law. For example, the CRA does not define a "low-" or "moderate-income neighborhood," and it gives only vague instructions regarding what steps a bank must take to satisfy the law's mandate.²⁴ Furthermore, con-

(OTS) regulates savings and loan companies insured by the FDIC. 12 U.S.C. § 2902(1)(A)-(D).

21. See Richard Marsico, *A Guide to Enforcing the Community Reinvestment Act*, 20 FORDHAM URB. L.J. 165, 170 (1993).

22. Rochelle E. Lento, *Community Development Banking Strategy For Revitalizing Our Communities*, 27 U. MICH. J.L. REF. 773, 774 (1994).

23.

12 U.S.C. § 2901 provides that:

(a) The Congress finds that—

- (1) regulated financial institutions are required by law to demonstrate that their deposit facilities serve the convenience and needs of the communities in which they are chartered to do business;
- (2) the convenience and needs of communities include the need for credit services as well as deposit services; and
- (3) regulated financial institutions have [a] continuing and affirmative obligation to help meet the credit needs of the local communities in which they are chartered.

(b) It is the purpose of this chapter to require each appropriate Federal financial supervisory agency to use its authority when examining financial institutions, to encourage such institutions to help meet the credit needs of the local communities in which they are chartered consistent with the safe and sound operation of such institutions.

12 U.S.C. § 2901.

24. *Id.*

trovsky surrounding the Congressional intent behind the CRA's adoption has made it difficult for those involved in enforcing and studying the law to determine how best to implement it.²⁵ Nowhere has congressional intent in the enactment of the CRA been more murky than over the role of racial considerations.²⁶

A. Racial Discrimination, Redlining and Community Disinvestment

Although many commentators stress the importance of the CRA in improving the credit and banking resources available to minorities,²⁷ Congress did not intend to remedy racial discrimination by lenders. Of course, one can reasonably assume that Congress knew that large numbers of minorities would benefit from the CRA.²⁸ However, Congress intended primarily to help local communities by encouraging banks to invest in neighborhoods that they historically ignored. The text of the CRA addresses geographic discrimination and did not, until 1991, even mention racial discrimination.²⁹ Further, the congressional debate surrounding the proposed CRA further evidences the legislators' understanding

25. See Anthony D. Taibi, *Banking, Finance, and Community Economic Empowerment: Economic Theory, Procedural Civil Rights, and Substantive Racial Justice*, 107 HARV. L. REV. 1463, 1487 (1994) (suggesting that racial discrimination and geographic discrimination, in the context of credit availability, are clearly interrelated).

26. *Id.*

27. *Id.* at 1406; see also Mollee Bennett, *Resolving the Community Reinvestment Act Dilemma: Eliminating "Whites Only" Mortgage Lending While Reducing Regulatory Red Tape*, 24 TEX. TECH. L. REV. 1145, 1148 (1993). Ms. Bennett posits that although there is no language in the CRA that speaks to race-based discrimination, "the scrutiny on low- and moderate-income neighborhoods has the practical effect of highlighting discrimination because these neighborhoods tend to be minority areas." *Id.*

28. Jonathan R. Macey & Geoffrey P. Miller, *The Community Reinvestment Act: An Economic Analysis*, 79 VA. L. REV. 291, 299 n.20 (1993) (discussing Congress' understanding of racial discrimination and the CRA).

29. See *supra* note 6; see also *Hicks v. RTC*, 970 F.2d 378, 382 (7th Cir. 1992) (finding that the language of the CRA does not address racially discriminatory lending policies). The 1991 amendment provides that an agency evaluation should consider losses or contributions when a bank donates, sells on favorable terms, or makes available rent-free a branch in a predominantly minority neighborhood to a minority bank or a women's bank. 12 U.S.C. § 2907. A 1992 amendment provided that an agency's evaluation should consider a majority-owned bank's capital investments, loan participation, and cooperative ventures with minority-owned and female-owned financial institutions and low-income credit unions. 12 U.S.C. § 2903(b). These recent amendments remain the only reference to race or gender in the CRA.

that the law was intended to improve banking services in poorer communities, irrespective of race.³⁰

Contemporaneous with the CRA, Congress passed other legislation that specifically addresses racial concerns.³¹ For example, in 1976, Congress enacted amendments to the Equal Credit Opportunity Act of 1974 to prohibit lending discrimination based on race, color, religion and national origin.³²

Congress adopted the CRA to remedy two very distinct, yet closely related, problems confronting inner city communities: redlining and community disinvestment.³³ The term "redlining" originated with the practice by executives at banks and other lending institutions of literally drawing a red line around a certain neighborhood and designating it as an area where no loans for

30. Sen. Morgan, in attacking the proposal, thought that the CRA would require an institution "to make an unsound loan in a specific location in order to meet its quota of loans in a given locality." 123 CONG. REC. 17,628. On the other hand, Sen. Sarbanes, in defending the proposal, asked, "[w]hy should not a banking institution have a responsibility to meet the credit needs of the local communities in which they are located." 123 CONG. REC. 17,633; *see also* Macey & Miller, *supra* note 28, at 299 n.20 (1993) (quoting from 123 Cong. Rec. 17,628 and 17,633 (1977)). Macey and Miller aptly sum up the role of racial discrimination in the enactment of the CRA: "This is not to say that concerns about race, ethnicity, or gender may not have been present in the minds of some members of Congress during the deliberations on the legislation. Such concerns, however, appear hardly at all in the written record, and appear at most as a subtext in the statements of certain legislators." *Id.*

31. Equal Credit Opportunity Act Amendments of 1976 (ECOA), Pub. L. No. 94-239, 90 Stat. 251. Congress amended the ECOA to provide the following:

(a) Activities constituting discrimination

It shall be unlawful for any creditor to discriminate against any applicant, with respect to any aspect of a credit transaction—

- (1) on the basis of race, color, religion, national origin, sex or marital status, or age (provided the applicant has the capacity to contract);
- (2) because all or part of the applicant's income derives from any public assistance program; or
- (3) because the applicant has in good faith exercised any right under this chapter.

15 U.S.C. § 1691(a) (1994). Failure to comply may result in actual or punitive damages, as well as for costs and attorneys' fees. *See* 15 U.S.C. § 1691e (1994).

32. *See* ECOA Amendments of 1976, 90 Stat. at 251 (amending 15 U.S.C. § 1691(a)). Also, the ECOA functions differently than the CRA in that it allows for a private cause of action against institutions. *See Hicks*, 970 F.2d at 382 (not allowing for a private cause of action based on the CRA). As discussed, the CRA only permits federal regulatory agencies to restrict a bank from making certain business transactions unless the bank has demonstrated some level of investment commitment to its local community. *See supra* note 23 and accompanying text.

33. *Hearings*, *supra* note 6, at 1.

business or property would be made.³⁴ Today, the term is used figuratively to define any institution's systematic pattern of lending discrimination.

Geographic redlining can stem from both rational and irrational decision making.³⁵ Banks rationally discriminate when they "restrict lending or are less aggressive in marketing loan products in certain neighborhoods because the costs of identifying the qualified loans are too high to be profitable."³⁶ Irrational redlining occurs when banks decide not to lend or to do business in a certain area because of prejudices wholly unrelated to the rationally perceived costs or credit risks.³⁷ The CRA's broad language makes no distinction between rational and irrational geographic redlining—a major criticism of banks.³⁸ Banking groups argue that penalizing rational behavior and encouraging irrational behavior forces banks to make unsound business decisions.³⁹

Closely tied to the concept of redlining is community disinvestment.⁴⁰ Community disinvestment occurs when a bank takes in

34. There are a number of definitions of redlining. For example, redlining has been defined as "the alleged bank practice of systemically denying mortgages in certain neighborhoods because of economic conditions or racial factors not strictly related to loan experience." Reinvestment: Public Deposits, COMP. NEWSL. (Council on Mun. Performance, New York, N.Y.), Feb. 17, 1977, at 1, reprinted in *Community Credit Needs: Hearings on S. 406 Before the Senate Comm. on Banking, Housing, and Urban Affairs*, 95th Cong., 1st Sess. 213 (1977); see also Richard A. Givens, *The "Anti-redlining Issue: Can Banks Be Forced to Lend?*, 95 BANKING L.J. 515 (1978) (defining redlining as a "restriction of credit based on geography as such, apart from any consideration of actual creditworthiness."). The latter definition more directly speaks to the goals of the CRA.

35. Brooke Overby, *Symposium: Shaping American Communities: Segregation, Housing & the Urban Poor: The Community Reinvestment Act Reconsidered*, 143 U. PA. L. REV. 1431, 1451 (1995).

36. William C. Gruben et al., *Imperfect Information and the Community Reinvestment Act*, FED. RESERVE BANK OF S.F. ECON. REV., Summer 1990, at 28 (discussing the CRA's impact on lending patterns).

37. Overby, *supra* note 35, at 1451.

38. 12 U.S.C. § 2901; see also statement of Sen. Morgan, *supra* note 11.

39. 123 CONG. REC. 17,628-17,629 (1977). In fact, the Act does not force banks to do anything. It merely "encourages" banks to invest in their local communities. 12 U.S.C. § 2901(b).

40. Some commentators see redlining as a specific type of disinvestment that is simply focused on perceived "poor credit risk" areas—lower income neighborhoods. Bennett, *supra* note 27, at 1147. However, the two cannot be linked in every instance. Overby, *supra* note 35, at 1451-2. For instance, a bank might invest outside of its community because that community has no credit needs. Thus, the bank's disinvestment is not redlining but simply sound business judgment. *Id.* This is an important distinction because the CRA calls for banks to act "consistent with the safe and sound operation of such facilities." 12 U.S.C. § 2901(b).

funds from one locality and reinvests in other areas.⁴¹ The title of the Act, the *Community Reinvestment Act*, evinces the enacting legislators' concern that disinvestment is a major cause of urban depredation, and one of the reasons for the CRA's adoption.⁴²

B. 1978 CRA Enforcement Regulations

Because of concerns that the CRA would lead to credit allocation,⁴³ legislators appeased banking groups and other lawmakers by imposing weak guidelines for enforcement.⁴⁴ Congress left it to the federal supervisory agencies to adopt specific enforcement regulations.⁴⁵

The agencies' 1978 regulations imposed three basic requirements on banks: community delineation, disclosure, and compliance.⁴⁶ Community delineation, how a neighborhood is defined, was left to the bank's discretion; however, a bank could not exclude low- or moderate- income areas, and it had to include the area contiguous to the offices of the bank itself.⁴⁷ The disclosure provision required banks to post a CRA notice for public view in their branches or

41. For a discussion of the different understandings of redlining and disinvestment, see Stephen Trzcinski, Note, *The Economics of Redlining: A Classical Liberal Analysis*, 44 SYRACUSE L. REV. 1197 (1993).

42. 123 CONG. REC. 17,603 (1977). Senator Proxmire stated that "[W]e find many banks and many savings and loan [sic] which take money from the community and reinvest it elsewhere, in some cases abroad, in some cases in other parts of the country. That is fine, provided it is not overdone. We have found many cases where these institutions have invested virtually nothing in the local community." *Id.*

43. Although the precise definition of credit allocation is a controversial issue, it can be defined as government-mandated lending quotas. See Orin L. McCluskey, *The Community Reinvestment Act: Is it Doing the Job?*, 100 BANKING L.J. 33, 38 (1983).

44. 123 CONG. REC. 17,628 (1977). Senator Garn, in arguing against the bill, stated during deliberations that: "[W]e are heading for credit allocation and Government bureaucrats sitting back here interfering with the private sector." Hearings on S. 406, *supra* note 6, at 324. Senator Proxmire, the main proponent of the CRA, stated with equal force that: "[T]his is not a credit allocation bill and I certainly don't see it that way. Whatever we can do to prevent it from being a credit allocation bill I want to do." *Id.* at 154.

45. See 12 U.S.C. §§ 2901-07.

46. Although under the CRA different institutions are governed by different federal agencies, the enforcement regulations promulgated by the agencies are identical. See FDIC Interp. Ltr. LEXIS 31 (May 17, 1995).

47. See Overby, *supra* note 35, at 1459. A bank could delineate its community by using the Standard Metropolitan Statistical Areas or political boundaries or portions thereof which surrounded the bank, its office, or branches; the local lending area surrounding each office or group of offices in which the bank made a substantial portion of its loans, and all other areas equidistant from those areas; and any other reasonably delineated local area that fulfilled the purpose of the CRA. *Id.* at 1459, n.126. See also 12 C.F.R. § 228.3(b) (1993).

office lobbies,⁴⁸ to inform customers and community residents of their rights under the CRA.⁴⁹ The compliance requirement subjected banks to a five-tiered numerical rating system,⁵⁰ but beyond that the directives were unclear.⁵¹

During its initial twelve years, from 1977 to 1989, the CRA required, in effect, nothing more than a good faith effort on the part of banks to become more aware of the communities in which they did business.⁵² As a result, between 1977 and 1988 the agencies blocked only eight of fifty-thousand applications for mergers or expansions due to a bank's failure to meet its CRA obligations.⁵³

C. FIRREA and Community Based Organizations

In 1989, in response to growing criticism of the effectiveness of the CRA,⁵⁴ Congress amended the law as part of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA).⁵⁵ FIRREA clarified the CRA in two significant ways. First, it required banks to disclose to the public its regulatory agency's written evaluation of its practices.⁵⁶ Second, the five-tiered numerical grading system was replaced with a system based on only four categories: (1) "outstanding," (2) "satisfactory," (3) "needs to improve," and (4) "substantial non-compliance."⁵⁷

48. See 12 C.F.R. § 228.6.

49. *Id.*

50. The system rated banks numerically from one to five. The definition of the numerical ratings were as follows: 1 = outstanding; 2 = good; 3 = satisfactory; 4 = needs improvement; 5 = unsatisfactory. See Glenn Canner, *The Community Reinvestment Act: A Second Progress Report*, 67 Fed. Res. Bull. 813, 816 n.1 (1981).

51. See 45 Fed. Reg. 63,133-134 (1980). For example the agencies, when assessing compliance, made their determinations based on banks' "sensitivity and response" to the credit needs of their local neighborhood. *Id.* at 63,134.

52. See *Community Reinvestment Act: Hearings Before the Senate Comm. on Banking, Housing, and Urban Affairs*, 100th Cong., 2d Sess. 7-8 (1988) [hereinafter *1988 Hearings*].

53. Bennett, *supra* note 27, at 1149.

54. See *1988 Hearings*, *supra* note 52, at 7-8. Senator Proxmire, in his opening statements, had the following to say: "Regulators seem to think that we're all living in Lake Woebegone. Like the children of the fictional village, U.S. lenders are all above average. Almost all get high ratings year after year and almost none is ever held back. The committee surveyed CRA rating procedures and found that more than 97 percent of all lenders passed with flying colors. . . . I wish we had graders like that when I was in school." *Id.*

55. Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, § 1212, 103 Stat. 183, 526-27 (amending 12 U.S.C. § 2906).

56. 12 U.S.C. § 2906(a).

57. 12 U.S.C. § 2906(b)(2).

These new provisions were to provide more specificity and a more neutral grading system for CRA examinations.⁵⁸

The regulatory agencies, in turn, put forth a joint policy statement explaining the new changes and the increased emphasis on documentation of bank compliance efforts.⁵⁹ In this policy statement, the agencies promulgated a list of twelve new assessment factors to be used by the agencies when examining banks for CRA compliance.⁶⁰ The factors provided banks and community groups with more detailed and specific guidelines for developing and assessing a CRA plan.⁶¹

58. Overby, *supra* note 35, at 1460-61.

59. See Statement of the Federal Financial Supervisory Agencies Regarding the Community Reinvestment Act, 54 Fed. Reg. 13,742 (1989); 12 C.F.R. § 25.7 (1992).

60. The twelve factors were:

- a) Activities conducted by the bank to ascertain the credit needs of its community, including the extent of the bank's efforts to communicate with members of its community regarding the credit services being provided by the bank;
- (b) The extent of the bank's marketing and special credit-related programs to make members of the community aware of the credit services offered by the bank;
- (c) The extent of participation by the bank's board of directors in formulating the bank's policies and reviewing its performance with respect to the purposes of the Community Reinvestment Act;
- (d) Any practices intended to discourage applications for types of credit set forth in the bank's CRA statement(s);
- (e) The geographic distribution of the bank's credit extensions, credit applications, and credit denials;
- (f) Evidence of prohibited discriminatory or other illegal credit practices;
- (g) The bank's record of opening and closing offices and providing services at offices;
- (h) The bank's participation, including investments, in local community development and redevelopment projects or programs;
- (i) The bank's origination of residential mortgage loans, housing rehabilitation loans, home improvement loans, and small business or small farm loans within its community, or the purchase of such loans originated in its community;
- (j) The bank's participation in governmentally insured, guaranteed, or subsidized loan programs for housing, small businesses, or small farms;
- (k) The bank's ability to meet various community credit needs based on its financial condition and size, and legal impediments, local economic conditions, and other factors; and
- (l) Other factors that, in the Comptroller's judgment reasonably bear upon the extent to which a national bank is helping to meet the credit needs of its entire community.

12 C.F.R. § 25.7 (1992).

61. 54 FED. REG. 13,743-44. The assessment factors were part of a larger discussion that addressed the agencies' views on all aspects of the CRA, including documentation and the role of the CRA evaluation in the examination process. *Id.* at 13,745-746.

Most importantly, by 1989 community based organizations (CBOs) started to become a powerful voice in the CRA examination process.⁶² Because of lax regulatory enforcement, CBOs took the lead in using the CRA to improve bank services in low- and moderate-income neighborhoods.⁶³ CBOs have done this in two ways: one, by raising challenges to bank applications with the regulatory agencies on the grounds that banks have not satisfied their CRA obligations; and two, by negotiating CRA lending agreements with banks.⁶⁴ This development was furthered by the 1989 amendments to the CRA.⁶⁵ The new disclosure requirements that gave the public greater access to CRA ratings strengthened the CBOs' position in challenging bank applications and in negotiating with banks. It also allowed CBOs to subject banks and their supervisory agencies to greater political pressure throughout the process.⁶⁶

Banks felt the impact of the amended CRA and the role of CBOs most acutely in larger transactions. For example, the Federal Reserve Board, when considering the application by BankAmerica to acquire Security Pacific, held public hearings in four cities and heard testimony from approximately 175 witnesses.⁶⁷ Although the merger was ultimately approved, organized protests by CBOs secured approximately \$12 billion from BankAmerica in community based lending commitments.⁶⁸

Although FIRREA and increased compliance requirements have greatly increased the role of CBOs in the CRA approval process, successes, such as the BankAmerica settlement, remain the exception. For instance, in 1990, the Federal Reserve Board de-

62. *1988 Hearings*, *supra* note 52, at 216 (noting that between 1984 and 1985 application protests increased from 3 to 19 and between 1986 and 1987 they increased from 20 to 36).

63. *See generally* Marsico, *supra* note 21.

64. *Id.*

65. *See supra* note 56-7 and accompanying text.

66. *See* Macey and Miller, *supra* note 28, at 301.

67. *See* Overby, *supra* note 35, at 1467. Professor Overby also posits that it was the 1989 Federal Reserve Board denial, partially on CRA grounds, of an acquisition application by Continental Bank Corporation and Continental Illinois Bancorp (not the new FIRREA amendments) that was responsible for the increased role of CRA compliance in the application process. *Id.* at 1465.

68. *Id.* at 1467. BankAmerica's commitments included: 1) \$150 million for long term financing of low-income housing; 2) \$100 for government sponsored small business programs; 3) \$200 million per year for conventional small business loans under \$50,000; and 4) \$12 million annually for a consumer loan program geared to low-income families. Status of the Community Reinvestment Act, S. REP. NO. 121, 102d Cong., 2d Sess. 25 (1992).

nied only one of twenty-seven CRA-protested applications.⁶⁹ Thus, although CBOs have found some success in the CRA-protest process it became increasingly apparent throughout the late 1980s and early 1990s that more needed to be done to strengthen the effectiveness of the CRA.⁷⁰ At the same time, however, banks that are subject to CRA regulation were becoming frustrated with the burden of complying with a law that many began to see as misguided.⁷¹

II. Criticisms of the CRA

Since its enactment in 1977, the CRA has been the subject of severe criticism. The criticism, however, hails from two very different perspectives. Some critics agree with the underlying theory behind the CRA—that banks should be encouraged to invest in their local communities—but argue that the regulatory agencies do not sufficiently enforce the CRA.⁷² Other critics doubt the potential benefit of the CRA, and argue that it should be abolished.⁷³ The latter group argues that even if the CRA were enforced properly, it can never be an effective means of rebuilding poorer communities.⁷⁴

69. See STAFF OF SENATE COMM. ON BANKING, HOUSING, AND URBAN AFFAIRS 102D CONG., 2D SESS., REPORT ON THE STATUS OF THE COMMUNITY REINVESTMENT ACT 1-6 (Comm. Print 1992). The Fed found that First Interstate BancSystem of Montana, Inc. had not met its CRA obligations when the bank attempted to merge with Commerce BancShares of Wyoming. 77 Fed. Res. Bull. 1007, 1007 (1991).

70. See Allen J. Fishbein, *The Community Reinvestment Act After Fifteen Years: It Works but Strengthened Federal Enforcement is Needed*, 20 FORDHAM URB. L. J. 293, 301-2 (1993). The first twenty-four months after the public disclosure provision was in effect, about two-thirds of all lenders were examined for CRA purposes. Of the banks examined, 9.7% were rated outstanding; 79% as satisfactory; 9.8% rated a needed to improve; .9% were in substantial non-compliance. This was only about an 11% failure rate (needs to improve or substantial non-compliance). Although this was an increase from the three years preceding the new requirements (which was about a 2.5% failure rate), the great majority of banks still passed. *Id.*

71. See generally, Macey and Miller, *supra* note 28, at 295. The authors argue that the CRA is based on outdated ideology. They posit that the Act is premised on a questionable model of credit markets, and that there are only normative grounds put forth in defense of localized community lending. *Id.*

72. See Fishbein, *supra* note 70.

73. See Macey & Miller, *supra* note 28, at 295.

74. *Id.*

A. The CRA: Ineffective Legislation?

Criticism concerning the overall viability of the CRA is, unsurprisingly, strongest from members of the banking community.⁷⁵ Banks generally argue that they bear too heavy a burden in relation to other financial institutions that are not regulated by the CRA,⁷⁶ and reject the idea that banking should be a localized industry.⁷⁷

The relaxation of interstate banking laws and improvements in information processing and communication have caused widespread consolidation in the banking industry.⁷⁸ Consolidation is thought to be more efficient and, consequently, more beneficial for all of society.⁷⁹ Some critics of the CRA argue that the nationalization and internationalization of the banking industry has rendered archaic the concept of a bank's responsibility for its immediate community.⁸⁰ The CRA impedes efficient consolidation of banking resources by allowing CBOs to intervene in the process of mergers and acquisitions⁸¹ and by strongly encouraging banks to invest in local communities.⁸²

Other commentators have suggested that bank consolidations might not be the most desirable result for the banking industry or

75. See Andrew Miller, *The New York Proposal To Revise The Community Reinvestment Act: A Quantitative Step Towards Objectivity And Effectiveness*, 43 CATH. U. L. REV. 951, 964 n.88 (1994) (citing Barbara A. Rehm, ABA: *Cost of Compliance Equals 59% of Bank Profits*, AM. BANKER, June 18, 1992, at 1, 12 (discussing banker opinion that compliance with the CRA is the most expensive component of federal bank regulation). The estimated cost of compliance with federal regulations, including the CRA, was equal to 59% of the commercial banking industry's total profits, or \$10.7 billion in 1991, according to the American Bankers Association. *Id.* at 1. Costs included salaries and benefits for employees hired to comply with regulations, as well as costs associated with outside consultants, lawyers, and employee training. *Id.* at 12). *Id.* Of course, there are also some scholars who question its worth in today's economy. See Lawrence J. White, *The Community Reinvestment Act: Good Intentions Headed in the Wrong Direction*, 20 FORDHAM URB. L.J. 281, 282 (1993) (stating that the CRA is "fundamentally flawed").

76. See *supra* note 7.

77. Miller, *supra* note 75, at 959-60.

78. See statement of Janet L. Yellen, 81 Fed. Res. Bull. 1093-97 (1995) (discussing the role of technology in the changing national and international banking structure).

79. Macey and Miller, *supra* note 28 at 322. The authors note that Harris Bancorp of Chicago aborted its merger with First Geneva Banqueshares allegedly because it anticipated a "needs to improve" rating from the Fed. *Id.* at 323.

80. See Macey and Miller, *supra* note 28, at 305-7 (discussing the expansion of the banking industry).

81. See Marsico, *supra* note 21 and accompanying text.

82. *Id.*

society.⁸³ For instance, mergers are often driven by inefficient or irrational motives such as managers' self-interest or vanity.⁸⁴ To characterize all bank mergers and acquisitions as efficient is to ignore the complex web of social and economic factors at work in the banking industry and the economy as a whole. Moreover, large banking institutions have a history of being unreceptive to small business and community institutions.⁸⁵ Thus, the CRA seeks to achieve economic efficiency while accounting for other societal goals and values, such as the promotion of small business.

CRA critics stress that the law only regulates certain financial institutions, placing them at a disadvantage in relation to other financial competitors in the marketplace.⁸⁶ CRA-regulated financial institutions complain that conforming with the law requires extensive documentation⁸⁷ that is expensive and time-consuming to prepare.⁸⁸ One commentator described this disadvantage as "a tax on covered financial institutions and their expansion."⁸⁹

CRA supporters respond to the disparate treatment argument by noting that CRA regulated depository institutions are granted special protection from the government.⁹⁰ These protections include deposit insurance and emergency funding in case of financial panic.⁹¹ Additionally, the regulated institutions "protect a large portion of society's assets, provide liquidity to the financial system,

83. See Taibi, *supra* note 25, at 1500 (critiquing neo-classical assumptions of banking and the CRA).

84. *Id.* at 1500-1. Professor Taibi notes that "most large bank mergers during the 1980s failed to reduce costs and actually lost value for the acquiring bank's shareholders; that mergers are often pursued for managers' self interest and that [m]assive banking consolidation would most likely reduce, not improve, industry efficiency." *Id.*

85. See Arthur E. Wilmarth, Jr., *Too Big to Fail, Too Few to Serve? The Potential Risks of Nationwide Banks*, 77 IOWA L. REV. 957, 1040 (1992).

86. See *supra* note 11. This concern was in large part the impetus behind a provision in the proposed 1993 Community Reinvestment Act Reform Act that sought to subject mortgage banks to CRA regulation. H.R. § 1700, 103d Cong., 1st Sess. § 101(a) (1993). The provision read: "each mortgage bank shall have an ongoing responsibility to meet the credit needs of all communities in which such bank makes a significant number of extensions of credit or extends a significant amount of credit, including extensions of credit in low- and moderate-income neighborhoods of such communities. *Id.* at § 201.

87. See Miller, *supra* note 75, at 964 n.88.

88. See Corman, *supra* note 12, at 7.

89. See Overby, *supra* note 35, at 1443.

90. See Miller, *supra* note 75, at 961 (discussing the "safety net" that banks receive from the Federal Reserve System).

91. *Id.*

and 'transmit' monetary policy."⁹² This important role in society justifies extra regulation such as the CRA.

In response, some commentators propose extending the CRA to include other non-bank financial institutions.⁹³ Many non-bank financial institutions are not subject to CRA regulation, but nonetheless enjoy many of the "safety net" benefits of the federal government.⁹⁴ Thus, the CRA's expansion is justified because many other institutions are receiving government benefits and because "[s]ociety has an interest in capital flows beyond ensuring that capital receives the greatest direct rate of return. It is legitimate for a democratic government to facilitate socially productive investment."⁹⁵ In other words, if these institutions are usurping large parts of traditional banks' roles in the market, then they should also adopt banks' social obligations. For instance, the mortgage industry has benefited greatly from a government-created secondary market for mortgage loans.⁹⁶

Another argument put forth by critics is that the CRA forces banks to allocate credit and banking services to high risk communities where return on capital or investment is low and risk is high.⁹⁷ The contention is that if CRA loans were safe and profitable, then banks would make them regardless of whether the CRA required it.⁹⁸ However, there is much recent empirical data which suggests that CRA loans are equally as safe as conventional loans, if not safer.⁹⁹

Further, this argument assumes that banks would act completely rationally, with no biases involved in lending or investment decisions. Also, the language of the CRA specifically calls for banks to make loans that are commensurate with safe and sound banking

92. *Id.* (The author also mentions the long history of regulation in the banking industry and the recent government bailout of the thrift industry as further justification, especially from a taxpayer's standpoint, for regulation such as the CRA).

93. Howard L. McMillan, Jr., *Dumb and Dumber (Credit Unions have Unfair Competitive Advantage Over Banks)*, A.B.A. BANKING J., March 1995, at 15.

94. *Id.* at 961-62.

95. Taibi, *supra* note 25, at 1496.

96. *Id.*

97. See Macey and Miller, *supra* note 28, at 321 ("[T]he CRA encourages depository institutions to devote depositor funds to low-profit or losing propositions in derogation of overall economic welfare. . .").

98. *Id.*

99. See generally THE WOODSTOCK INSTITUTE AND THE NATIONAL ASSOCIATION OF AFFORDABLE HOUSING LENDERS, SOUND LOANS FOR COMMUNITIES: AN ANALYSIS OF THE PERFORMANCE OF COMMUNITY REINVESTMENT LOANS (1993) (concluding from a sample of CRA loans that single-family CRA loans had substantially lower delinquency rates than conventional loans).

practices.¹⁰⁰ The CRA was written specifically to avoid credit allocation by giving banks the ability to choose the loans and investments that they could make.¹⁰¹

B. Enforcement Criticisms

CRA commentators and proponents both decry the lack of purposeful agency enforcement.¹⁰² Proponents of the CRA complain that the federal supervisory agencies tend to stress procedure and documentation over actual performance when reviewing CRA compliance efforts.¹⁰³ Many commentators and community groups desire more objective and results-oriented examinations.¹⁰⁴ Because of the agencies' orientation towards process and not results, community activists argue that the Act has not become a truly effective tool against the dearth of banking and credit services in poorer neighborhoods.¹⁰⁵ In fact, if it were not for the development of CBOs involvement, the CRA would be almost completely ineffective.¹⁰⁶

III. A Results-Oriented Community Reinvestment Act

Relentless criticism led the federal regulatory agencies to publish initial CRA regulation revision proposals in December 1993.¹⁰⁷ These proposals were revised in 1994, and finalized in April of 1995.¹⁰⁸ Some members of Congress, however, have lost faith in the CRA and have responded with a litany of attacks to abolish it,

100. See *supra* note 23 and accompanying text.

101. See *supra* note 44 and accompanying text.

102. See generally Fishbein, *supra* note 70 (discussing the lack of effective implementation by federal supervisory agencies).

103. *Id.*

104. See Michael Klausner, *Symposium: Shaping American Communities: Segregation, Housing & the Urban Poor: Market Failure and Community Investment: A Market-Oriented Alternative to the Community Reinvestment Act*, 143 U. PA. L. REV. 1561, 1564 (1995) (discussing the willingness of banks to accept the CRA under a more results-based regime).

105. Fishbein, *supra* note 70, at 296-97.

106. *Id.* See also Marsico, *supra* note 21, at 171 (noting that federal regulators have been hesitant to enforce aggressively the CRA and that CBO's have been the ones using it to further development in low- and moderate-income communities).

107. See Community Reinvestment Act Regulations, 58 Fed. Reg. 67,466, 67,467 (1993) (proposed Dec. 21, 1993) (the federal agencies conducted one of the most extensive rule-making proceedings in their history—including a series of seven public hearings around the nation that received over 6,700 comment letters, 50 other submitted written statements, and heard from over 250 witnesses).

108. Community Reinvestment Act Regulations, 60 Fed. Reg. 22,156 (1995) (to be codified at 12 C.F.R. §§ 25, 228, 563e, 203, 345) [hereinafter *Final Regulations*].

or to curtail the effectiveness of the new regulations.¹⁰⁹ Although the onslaught from members of Congress and other critics continues,¹¹⁰ the new regulations offer both the banking industry and community groups significantly improved possibilities to achieve their goals under the CRA. Thus, Congressional critics should slow their attack on the CRA and allow the new regulations to take effect before proposing further amendments.

A. Final Regulations

The new regulations abandon the 12 factor assessment criteria¹¹¹ and replace them with a three-pronged evaluation method: (1) the lending test; (2) the service test; and, (3) the investment test.¹¹² Also, in response to past criticisms, the regulations provide separate performance criteria for certain small banks and wholesale or limited purpose institutions.¹¹³ Banks no longer have the requirement of preparing and filing a detailed CRA statement for each delineated community they serve.¹¹⁴ Instead, banks need only submit the information that they normally would develop to identify potential markets and customers.¹¹⁵ Also, the regulations provide an alternative strategic plan¹¹⁶ that allows banks to assess their CRA requirements before applying to an agency.¹¹⁷ These tests and performance criteria offer banks, regulators and community groups clearer and more objective standards when examining CRA compliance.

109. See *supra* note 13 (listing a number of recently proposed Congressional bills intended to undercut the CRA).

110. *Id.* See also Claudia Cummins, *U.S.: Vary CRA Rules for Big, Small Banks*, AM. BANKER, Dec. 9, 1993, at 1, 3 (discussing the data collection requirements under the new regulations).

111. See *supra* note 60 and accompanying text.

112. FDIC Interp. Ltr. LEXIS 31, 46-50 (May 17, 1995) (discussing the new regulations).

113. *Id.* at 75-78.

114. *Id.* at 49.

115. *Id.* at 81-87. "Wholesale" institutions are those that do not provide "home mortgage, small business, small farm, or consumer loans to retail customers." "Limited purpose" institutions are those that provide "only a narrow product line, such as credit cards, to a regional or broader market." *Id.* at 4-6.

116. See *infra* Part III, § A(1) (discussing the new strategic plan available as an option to banks).

117. FDIC Interp. Ltr., *supra* note 112, at 49-50.

1. *New Tests*

Lending activity remains the primary focus in a CRA evaluation.¹¹⁸ The "lending test" assesses a bank's CRA compliance by evaluating the bank's record of home mortgage lending, small business lending, small farm lending, consumer lending¹¹⁹ and community development lending.¹²⁰ Each bank will be rated within its assessment area on its willingness to meet credit needs; its volume of lending; the geographic distribution of loans among individuals of different income levels and businesses; its lending record to the most disadvantaged sections of the area, and to low income individuals and businesses; its use of innovative lending practices; and its leadership position in community development lending.¹²¹

The agencies will base their evaluations on loan originations and purchases rather than on outstanding loans.¹²² This approach is better for all actors involved in the CRA process. It provides a more accurate reflection of a bank's current activity by minimizing any obscurity caused by past activity,¹²³ without increasing the bank's data collection requirements.¹²⁴

118. See Williams & Gracin, *supra* note 17, at 5. Lending, particularly retail, residential real estate, small business and small farm lending, is the main focus of the new regulations. The primary factor contributing to a CRA rating will be the volume and distribution of a bank's loans. See Jeanine Catalano, *New CRA Regulation May Pose More Problems For Banks Than Old One*, 14, No. 12 BANKING POL'Y REP., June 19, 1995 (page reference not available).

119. Consumer loans are those that are extended to one or more individuals for household, family, or other personal expenditures. See *supra* note 112, at 35.

120. "Community development lending" is defined as: (1) Affordable housing (including multifamily rental housing) for low- or moderate-income individuals; (2) community services targeted to low- or moderate-income individuals; (3) activities that promote economic development by financing businesses or farms that meet the size eligibility standards of 13 CFR § 121.802(a)(2) or have gross annual revenues of \$1 million or less; or (4) activities that revitalize or stabilize low- or moderate-income geographies. See *supra* note 112, at 24-25.

121. See Overby, *supra* note 35, at 1470-71. For an "Outstanding" (O) under the lending test, the institution must generally have "excellent responsiveness" in this category; for a "high satisfactory" (HS), "good responsiveness;" for a "low satisfactory" (LS), "adequate responsiveness;" for a "needs to improve" (NI), "poor responsiveness;" and for a "substantial noncompliance" (SN), "very poor responsiveness." The same grading system is applied to the other tests. *Id.* at 1471 n.187(citing forthcoming codification in 12 C.F.R. pt. 228, app. A(b)(1)(i)(A), (ii)(A), (iii)(A), (iv)(A), (v)(A)).

122. See FDIC, *supra* note 112, at 53-54. A loan "originates" at the time it is issued. Thus, the new regulations evaluate how many loans were issued at any given time, not how many loans are actually outstanding.

123. Although, a bank nonetheless can opt to provide data on loans outstanding, "which may, in certain circumstances, enhance an examiner's understanding of an institution's performance." *Id.* at 54-56.

124. *Id.* at 54.

The "investment test," in keeping with the essence of the new regulations, emphasizes the actual investments made by a bank.¹²⁵ The supervisory agency's examination will consider the number of "qualified investments,"¹²⁶ the innovativeness and complexity of the qualified investments and the bank's responsiveness to the credit and economic development of the community.¹²⁷ This is significant because it allows banks alternative ways to fulfill their CRA obligations.¹²⁸

Under the "service test," the agency evaluates a bank's geographic distribution of branches within its service area, its number of branch openings and closings, its alternative systems¹²⁹ of banking services available to low- and moderate-income individuals and areas, and the type of services offered.¹³⁰ The bank's branches and other delivery systems, do not have to be accessible to every part of its assessment area but there cannot be "conspicuous gaps in accessibility, particularly to low- or moderate-income areas or individuals."¹³¹ The examining agency will also consider the extent of the bank's innovativeness and responsiveness to community develop-

125. See FDIC, *supra* note 112.

126. "Qualified investments" include, but are not limited to, investments, grants, deposits or shares in or to financial intermediaries that primarily lend to low- or moderate-income areas or individuals, for the purpose of community development. *Id.* at 41.

127. *Id.* at 69.

128. The concept of allowing a bank to fulfill its CRA obligations simply by investing, with nothing else, is criticized by some community groups. Swidler, *infra* note 157, at 412-13. However, the new regulations do not allow banks to "invest away" their CRA obligations. Instead, consideration of investments is only one piece of a larger whole. Community development corporations (CDCs) are one example of an innovative investment plan a bank might undertake. CDCs are organizations, comprised of local financial institutions, created specifically to address community lending and financial needs. Overby, *supra* note 35, at 1525-26. By pooling their resources in a CDC, banks can reduce the costs associated with identifying potential borrowers and processing information related to those borrowers. *Id.*

129. Automatic teller machines are an example of an alternative delivery system, although the regulations give more weight to branches that offer a broader range of services. See FDIC, *supra* note 112, at 72.

130. Overby, *supra* note 35, at 1472. The test focuses on an institution's current distribution of branches and "does not require an institution to expand its branch network or operate unprofitable branches." See FDIC, *supra* note 96, at 73.

131. See FDIC, *supra* note 112, at 74.

ment services,¹³² and its leadership position in providing those services.¹³³

2. *Alternative Evaluation Methods*

The "community development test" is available to wholesale and limited purpose institutions that, because they do not offer traditional banking services, have difficulty meeting the criteria of the other tests.¹³⁴ Under this test, the bank will be evaluated by its record of making qualified investments, by its involvement in community development lending, and by its record of offering community development services.¹³⁵ The community development test evinces an understanding on the part of the federal agencies that not all banks operate the same. By granting consideration to activities that are targeted to broader statewide or regional areas, and by granting CRA credit to wholesale or limited purpose institutions for servicing areas beyond their delineated assessment area,¹³⁶ the agencies have given banks more flexibility in meeting their CRA obligations.

In the same vein, the test for small retail institutions¹³⁷ acknowledges the fact that small banks operate differently from large banks. Under the "small institutions performance standards," the focus is on the bank's loan-to-deposit ratio in relation to reported loans to low- and moderate-income individuals, loans to small businesses and farms, loans in low- and moderate-income geographies and other lending related activities, while focusing on the bank's responsiveness to public complaints concerning the bank's efforts to meet its community credit needs.¹³⁸ A small bank only needs to

132. See *supra* note 108. "Community development services" are defined as services that focus primarily on community development, that are related to the provision of financial services, and that are not otherwise considered under the service test. *Id.* (to be codified at 12 C.F.R. § 228.12(j)).

133. See *supra* note 108 (to be codified at 12 C.F.R. pt. 228, app. A(b)(3)(i)(D), (ii)(D), (iii)(D), (iv)(D), (v)(D)).

134. See *supra* note 115 (defining "wholesale" and "limited purpose" institutions).

135. See *supra* note 108. See also *supra* note 109 for a definition of qualified investments; *supra* note 103 for a definition of community development lending; *supra* note 114 for a definition of community development services.

136. See Williams and Gracin, *supra* note 118, at 7 (discussing the diminishment of the significance of a bank's restriction to its assessment area/community delineation for CRA credit).

137. "Small retail institutions" are defined as independent institutions with assets of less than \$250 million or affiliates of a holding company with total banking and thrift assets of less than \$1 billion. See *Final Regulations*, *supra* note 108 (to be codified at 12 C.F.R. § 228.12(t)).

138. *Id.* (to be codified in various sections of 12 C.F.R. § 228).

achieve an overall satisfactory rating in order to be granted an outstanding rating under the small institutions performance standards.¹³⁹ And, most importantly, small banks are exempted from the loan reporting requirements of larger banks, lessening their compliance burden.¹⁴⁰ This evaluation method is significant because it is estimated that up to 85% of CRA regulated institutions are in this group.¹⁴¹

The "strategic plan" option is the most significant part of the Final Regulations.¹⁴² As an alternative to being rated under the lending, service, and investment tests, a bank can submit to its supervisory agency a detailed plan, developed with community input, that describes how it proposes to meet its CRA obligations.¹⁴³ The plan must set forth sufficiently detailed and measurable goals for meeting its community credit needs to allow the public and the supervisory agency to judge its merits.¹⁴⁴ The bank's performance will then be assessed by how well it meets the goals of its plan.¹⁴⁵ If a bank cannot meet the goals of its strategic plan, it nonetheless has the ability of being evaluated under normal applicable assessment criteria.¹⁴⁶

139. *Id.* (to be codified in 12 C.F.R. pt. 228, app. A(d)(2)).

140. *Id.* (to be codified in 12 C.F.R. § 228.42(a)).

141. See Overby, *supra* note 35, at 1477 n.220

142. See *Final Regulations*, *supra* note 108 (to be codified at 12 C.F.R. §§ 228.21(a)(4), 228.27)

143. *Id.* See also *supra* note 115, at 82.

144. See *Final Regulations*, *supra* note 108 (to be codified at 12 C.F.R. 228.27(d)). The bank must, for a minimum of 30 days before submitting the plan to its supervisory agency, seek public comment on its plan. At least three months before the effective date of the plan, the bank must submit the proposed plan to its supervisory agency along with: (i) a description of its formal and informal efforts to seek suggestions from the public; (ii) any written public comments received; and (iii) if revisions were made in response to public comment, the initial strategic plan as was first released to the public. Each institution is judged in the context of its own characteristics, including its particular community, business operations and level of CRA activity, in light of similarly situated institutions. Further, the agency will consider (i) the extent of lending related activities, (ii) the amount, innovativeness, complexity, and responsiveness of qualified investments, (iii) the effectiveness and availability of the bank's services, and (iv) the extent and innovativeness of the bank's community development services. *Id.* (to be codified at 12 C.F.R. § 228.27(g)(2)-(3)). See also Williams and Gracin, *supra* note 118, at 7; Overby, *supra* note 35, at 1478 n.234.

145. *Id.* If the supervisory agency does not approve or disapprove of the submitted plan within sixty days, the plan is automatically approved. Williams and Gracin, *supra* note 118, at 7.

146. *Id.* The plan must require a bank to achieve a minimum rating of satisfactory. FDIC, *supra* note 108, at 85. An outstanding rating is available only if the plan contains goals for outstanding ratings. *Final Regulations*, *supra* note 108 (to be codified at 12 C.F.R. § 228.27(f)(3)).

IV. Evaluation and Recommendations

A. Evaluation

Further CRA amendment, without seeing the effects of the recently adopted federal supervisory agencies' regulations, would be premature at this point. The Final Regulations answer effectively many of the criticisms and questions raised by the banking industry and community groups. Given the research and extensive rulemaking proceedings undertaken by the federal supervisory agencies,¹⁴⁷ it would be imprudent for Congress to enact legislation that abolishes or undercuts the CRA without giving the new regulations a chance to be implemented fully and to take effect.¹⁴⁸

The Final Regulations provide financial institutions with more objective criteria to assess their CRA performance.¹⁴⁹ For example, the strategic plan option provides an institution with complete certainty of its CRA position.¹⁵⁰ Although the plan requires a bank to solicit frequently unwanted community input, at least the bank will be better able to assess its position beforehand. Given the increasing strength of CBOs,¹⁵¹ the plan allows banks to calcu-

147. See *supra* note 107.

148. See Letter from John Hawke, Under Secretary, U.S. Dept. of the Treasury, to The Honorable James A. Leach, Chairman, U.S. House of Representatives Committee on Banking and Financial Services (Nov. 3, 1995) ("[B]y focusing on hard data about lending, services, and investments, the rules will narrow the issues over which institutions, regulators, and community groups can disagree, and reduce the likelihood that a protest will raise new information that delays application-processing.").

149. Because the CRA does not mandate credit allocation, there must be room for some agency discretion. However, the new regulations balance this need with the need for more objectivity in the examination process. See *Final Regulations, supra* note 108 (to be codified in 12 C.F.R. § 228.21(b)). The examining agency evaluates a bank under the tests within the context of information about the bank, its community, its competitors, and its peers. The agency will consider the following:

- (1) The economic and demographic characteristics of the institution's assessment area, including median income levels, housing information;
- (2) Information concerning the institution's lending, investment and service opportunities in its assessment area;
- (3) The institution's product offerings and business strategy;
- (4) The institution's financial and economic capacity and constraints;
- (5) The prior performance of the institution and the performance of similarly situated situations;
- (6) The institution's public file;
- (7) Any other relevant information.

Id.

150. See *supra* note 142 and accompanying text.

151. See Dominic Bencivenga, *Challenging Bank Deals: New Tactic Wins Review of Regulatory Approval*, N.Y. L.J., Oct. 19, 1995, at 5 (col. 2). The author describes community groups such as Inner City Press/Community on the Move as no longer just an annoyance to banks seeking to merge or consolidate, but as a "major headache."

late their transaction costs more efficiently. Furthermore, banks can only gain positive publicity by announcing their plans to invest in local communities.¹⁵²

Community groups also will benefit from the Final Regulations. By encouraging public input, the agencies have acknowledged the importance of local community groups in the CRA process.¹⁵³ Banks, instead of seeing CBOs as their opponents in a merger or acquisition,¹⁵⁴ will be more apt to cull information from CBOs to lessen their compliance costs. Because community groups make it a practice to be more informed about the credit needs of their specific community,¹⁵⁵ banks have added incentive to work closely with CBOs in order to reduce their research costs.¹⁵⁶

Furthermore, CBOs can play an important role after CRA loans are extended. Too often, prospective borrowers have very little experience in the loan process and either have trouble obtaining the loan or, once it is obtained, have trouble budgeting their financial resources and debts.¹⁵⁷ Thus, a bank working closely with community groups decreases its initial costs in finding CRA borrowers, and decreases the possibility of incurring costs later due to loan delinquency. Any proposed legislation to curtail the development of these relationships between banks and communities would gut the effectiveness of the CRA.¹⁵⁸

The group is just one of many that has challenged agency determinations in federal court. *Id.*

152. See, e.g. *CRA: Wells Fargo Pledges \$45 Billion in Loans in Move to Sweeten First Interstate Bid*, BNA BANKING DAILY, Dec. 15, 1995, at d2 (discussing Wells Fargo CRA pledge that includes \$25 billion for small business; \$8.5 billion for commercial economic development; \$7 billion for affordable housing and community development efforts; \$2 billion in loans for low-income consumers; and \$500 million in other community development investments).

153. See *supra* note 142.

154. See *supra* note 144.

155. CBOs are just that—community organizations. They are in touch, not only with individual consumers, but with churches, labor unions, professional associations, charities, and other organizations with banking needs. Fishbein, *supra* note 65, at 304.

156. See Claudia Cummins, *Texas Commerce Puts Teamwork Into CRA*, AM. BANKER, Sept. 9, 1993, at 18 (stating that bankers “need to access the expertise that already exists in community lending, redevelopment, and affordable housing, and find partners that know how to get the dollars into the community.”).

157. See Gary M. Swidler, Note, *Making the Community Reinvestment Act Work*, 69 N.Y.U. L. REV. 387, 416 (1994) (noting that community groups such as the Association of Community Organizations for Reform Now (ACORN) employ training programs designed to explain the workings of mortgage loans while stressing to potential borrowers the importance of making each scheduled payment on time).

158. See *supra* note 109. For example, H.R. 2520, in seeking to lessen banks' data collection requirements, would do away with the public notice requirement in the CRA. Hawke, *supra* note 148. The bill “insulat[es] institutions from meaningful re-

B. Recommendations

Because the CRA is an effective means to improve communities through economic development,¹⁵⁹ Congress should extend the law to institutions not currently regulated by it. For example, mortgage companies, though not traditional banking entities, have become a force in the residential real estate market and a consumer credit source.¹⁶⁰ The fact that mortgage companies lend regionally or nationally and therefore have no traditional "community," is an issue that can be resolved under the Final Regulations. For mortgage companies, the appropriate examining federal supervisory agency could emphasize the lending test¹⁶¹ and investment test¹⁶² and either recommend or request a plan geared toward a targeted area or areas.¹⁶³

This rationale is in keeping with Congress' broader view of the concept of "convenience and needs" as it applies to the CRA.¹⁶⁴ Although the concept is found throughout federal and state banking and regulations,¹⁶⁵ it has taken on a different meaning with the CRA. Ordinarily, the phrase addresses traditional considerations of competition and sound business sufficient to ensure a bank's success.¹⁶⁶ The CRA, however, expands the phrase to require banks to meet specific community credit needs.¹⁶⁷ Thus, "convenience and needs" is not a static phrase. As the understanding of

view under the CRA. Persons concerned about an institution's performance would have no notice of the proposed transaction, and thus no timely opportunity to voice their concerns and offer supporting evidence." *Id.*

159. See Griffith L. Garwood & Dolores S. Smith, *The Community Reinvestment Act: Evolution and Current Issues*, 79 Fed. Res. Bull. 251 (1993) (noting the CRA's influence on improving community development).

160. Overby, *supra* note 35, at 1524. Obviously, those in the mortgage industry have not reacted positively to the idea of possible CRA regulation. Rik Forgo, *Respite May End for Mortgage Bankers*, THE THRIFT REGULATOR, Oct. 25, 1993, (no page citation). Mike Farrell of the Mortgage Bankers Association of America questions whether the underlying nature of the CRA should make it applicable to mortgage banks. *Id.*

161. *Supra* note 112, at 24-25 and accompanying text.

162. *Supra* note 112, at 28-29 and accompanying text.

163. Unless an institution chose to be evaluated under one of the alternative methods. See *supra* note 133 and accompanying text.

164. 12 U.S.C. § 2901.

165. See the Change in Bank Control Act, 12 U.S.C. § 1817(j)(7)(B); the Bank Merger Act, 12 U.S.C. § 1828(c)(5)(B); and section three of the Bank Holding Company Act, 12 U.S.C. § 1842(c)(2).

166. Joseph J. Norton, "Fair Lending" Requirements: *The Intervention of a Governmental Social Agenda Into Bank Supervision and Regulation*, 49 CONSUMER FIN. L. Q. REP. 17, 24 (1995).

167. *Id.*

community takes on a different and broader meaning, so should the understanding of community “convenience and needs.”

Similarly, credit unions should be subjected to CRA regulations. Once very specialized institutions for union members and other workers that shared some “common bond,” credit unions increasingly are operating more and more like traditional banks.¹⁶⁸ Much the way banks do, credit unions offer auto loans, credit cards, mortgages, personal loans and even mutual funds.¹⁶⁹ Thus, given the enormity of the credit union industry,¹⁷⁰ subjecting it to CRA examination would have the two-fold effect of (i) leveling the playing field vis-a-vis other financial institutions and, (ii) increasing the financial resources available to communities.

Congress and the federal regulatory agencies should not gut a law that is essential to rebuilding communities simply because its administration is becoming increasingly difficult with the growing complexity of the banking and finance industry. Instead, Congress should seek to establish a fairer, more comprehensive and unified regulatory structure that incorporates banks and major bank-like financial institutions, such as mortgage companies and credit unions.¹⁷¹

At the same time, investment in community development corporations (CDCs)¹⁷² should be encouraged by legislators and the agencies.¹⁷³ CDCs are organizations of local financial institutions, created specifically to address community lending and financial needs.¹⁷⁴ First, banks will benefit from the information-gathering and compliance-cost reduction that comes with working with other institutions.¹⁷⁵ Second, because the financial needs of neighbor-

168. See McMillan, *supra* note 93, at 15.

169. *Id.*

170. Mr. McMillan notes that credit unions reported a net income of \$3.7 billion in 1993 and that they are presently a \$300 billion a year industry. *Id.*

171. Taibi, *supra* note 25, at 1505 (discussing the spread of multifunctional financial conglomerates and the emergence of an unregulated parallel banking system). Prof. Taibi also notes that there are many commentators, including financial reformer Tom Schlesinger and Chicago Mercantile Exchange Commission Chairman Jack Sandner, that promote regulating all sectors of the financial industry. *Id.*

172. See *supra* note 128 for a definition of CDCs.

173. Because CDC-type investments are incorporated primarily under the investment test, and the lending test is given the most weight in the ratings process, CDC investments are greatly under-recognized. See *supra* note 112 and accompanying text for a discussion of the test criteria.

174. See *supra* note 128 and accompanying text.

175. Overby, *supra* note 35, at 1526, n.397 (quoting William C. Gruben et al.: “Since these same individual institutions perform many other types of loan functions in-house, it is clear. . . that the establishment of such consortia serves the purposes of

hoods vary considerably, it is difficult for even the best-intentioned bank to determine a particular neighborhood's specific financial needs.¹⁷⁶ CDCs provide an opportunity to maximize the capital available from banks with the information available from those immersed in the community. Third, regulated investment in CDCs will impede the growth of illegal credit organizations, such as loan-sharks—an increasing source of credit for those without banking services.¹⁷⁷

Conclusion

The Community Reinvestment Act is effective legislation. Its lack of efficacy thus far has been not because it is inherently flawed. Rather, the CRA's troubles have stemmed from its application. By omitting financial institutions that should be governed by the CRA, Congress has not applied the law fairly. At the same time, Congress and the federal supervisory agencies have not applied the CRA rationally to those financial institutions that have been governed. Thus, the CRA should not be curtailed, but strengthened by extending it to include currently unregulated financial institutions and by encouraging more innovative investment, such as CDCs. However, any steps taken should be in tandem with a careful study of the effects of the federal supervisory agencies' recently issued Final Regulations.

lowering per-institution costs of information and of spreading risk in a lending process where such costs and risks are relatively high.”).

176. Purdy & Sexton, *supra* note 1, at B6.

177. *Id.*