At its core, the CRA helps to overcome market failures in low- and moderate-income communities. By fostering competition among banks in serving low- and moderate-income areas, the CRA generates larger volumes of lending from diverse sources, and adds liquidity to the market, decreasing the risk of each bank’s loan. Encouraged by the law, banks and thrifts have developed expertise in serving low-income communities, and they have created innovative products that meet the credit needs of these areas with manageable risks.

These market innovations have taken several forms. Banks and thrifts have engaged in special marketing programs to targeted communities; experimented with more flexible underwriting and servicing techniques to serve a broader range of households, and funded credit counseling for borrowers. Many larger institutions have developed specialized units that focus on the needs of low- and moderate-income communities. The CRA also facilitates coordination among banks to reduce information costs. For example, it has spurred the development of multi-bank community development corporations and loan consortia to serve low- and moderate-income communities more effectively. Others have formed partnerships with community based organizations and community development financial institutions (CDFIs). CDFIs provide specialized expertise and local market knowledge, and assume portions of risk that banks do not want to bear. Spurred in part by the CRA investment test, banks have invested in CDFIs in record numbers, strengthening the ability of both banks and CDFIs to serve low-income markets. Moreover, banks have recently begun to develop and deploy new low-cost, electronically based bank accounts with debit card access, to provide essential financial services to low-income customers at low cost and low risk.

Critics contend that the CRA has provided little benefit at a very high cost. Yet empirical studies have found that the CRA has had a significant impact on meeting the credit needs of low-income communities and borrowers. Research by Brookings and Harvard’s Joint Center for Housing Studies found that, between 1993 and 1999, depository institutions covered by the CRA and their affiliates made over $800 billion in home mortgage, small business, and community development loans to low- and moderate-income borrowers and communities. The number of CRA-eligible mortgage loans increased by 39 percent between 1993 and 1998, while other loans increased by only 17 percent. Even excluding affiliates, banks increased their lending to low- and moderate-income borrowers and areas by 10 percent over this period, compared with no growth at all for these lenders in their other markets.

Even controlling for the effects of external factors—such as strong economic growth and low inflation—CRA lenders increased their CRA-eligible home purchase lending faster than those not regulated by the CRA from 1993 to 1999. The Joint Center concluded: “CRA-regulated lenders originate a higher proportion of loans to lower income people and communities than they would if CRA did not exist.” By one estimate, the Joint Center found that the CRA’s effect on increasing home mortgage lending to low-income borrowers was equivalent to a 1.3 percentage point decrease in unemployment. Another study found that the CRA boosts the number of small businesses that can access credit.
by four to six percent, increasing payrolls and reducing bankruptcies—without crowding out other financing available to small businesses or adversely affecting bank profitability or loan performance.  

Critics of the CRA assert that it leads to unprofitable lending and that the costs of compliance are too high. But the weight of evidence suggests otherwise. In a Federal Reserve Board survey of CRA-covered institutions, for example, most institutions responded that CRA lending was profitable or marginally profitable, and not overly risky. Pushing further into low-income markets has not weakened banks’ profitability or soundness and has generated new business opportunities. CRA compliance also does not appear to be a drag on the efficiency of banks and thrifts or the financial sector as a whole.

In sum, recent empirical evidence shows that the CRA is working for America’s communities. Careful attention to obtaining real results under the Community Development Test will be critical for intermediate-sized banks. The key question is whether financial institutions will continue to develop new products and services to meet the needs of low- and moderate-income communities. With continued private sector innovation, the CRA can help to further expand opportunities for low-income families, help grow small businesses, and strengthen communities in the years ahead.

Interested in learning more about the recent changes to the Community Reinvestment Act?

Join us for the 2006 National Community Reinvestment Conference: Winning Strategies for Community Development. The conference brings together the field’s leading experts for training and thought-provoking discussions on the most promising strategies for revitalizing our nation’s distressed communities. Included is an entire track dedicated to CRA compliance training, with special attention given to the new intermediate small bank category and the expanded definition of “community development.” Also featured are sessions covering innovations in community development investing, strategic approaches to community development, and the National Community Development Lending School.

Visit www.frbsf.org/community to access the conference brochure and to register online. Please note that the deadline for registration is March 3rd, and the deadline for group rate hotel reservations is February 15th.
Credit Where it Counts


2. Litan and others (2001); Belsky, Schill, and Yezer (2001)