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Optimal CRA Reform

Balancing Government Regulation and Market Forces

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Preface

Early this year, economists were cautiously optimistic about the state of the economy and were speculating about the strength of the recovery. A series of emerging corporate scandals have cast a shadow on these hopes, roiled the financial markets, and revealed profound weaknesses that had not previously been recognized. Viewing these developments from a broader perspective, a number of observers have revisited the issue of the role of government vis-à-vis the private sector, challenging widely held precepts about the viability of laissez-faire policies.

These developments will surely influence regulators and other stakeholders as they craft new rules for the Community Reinvestment Act of 1977 (CRA). This important law is the main safeguard by which the government attempts to ensure that financial institutions treat low- and moderate-income Americans evenhandedly. At issue in the regulatory overhaul are the various yardsticks regulators use to judge whether individual institutions are meeting the credit and service needs of low- and moderate-income communities.

The history of the CRA, as told by Kenneth Thomas in this new brief, represents a classic tug-of-war between various competing interests. When the government has reviewed the CRA rules in the past, groups with a stake in the outcome—grassroots activists, regulators, and financial institutions—struggled mightily to tip the balance of power in their favor. Thomas argues in this paper that if the new rules are to succeed, regulators will have to strike a delicate balance between these interests.

Several of Thomas's proposals illustrate this imperative. To offset the effects of a sometimes cozy relationship between industry and government agencies, Thomas suggests that the rules should mandate very explicit and objective measures of institutions' lending performance. To relieve the burden of compliance, the rules should be simplified and pared down to their essentials. To prevent banks from taking advantage of vulnerable members of low- and moderate-income communities, rule makers should adopt strong measures against "predatory lending."

These ideas, and the many other useful proposals in this brief, should be carefully considered in the months ahead. As always, your comments are welcome.

Dimitri B. Papadimitriou, President
August 2002

Optimal CRA Reform

The Community Reinvestment Act of 1977 (CRA) is proof that capitalism can have a corporate conscience without degrading into socialism or gambling on the other extreme of completely unregulated markets.[1] CRA is arguably a perfect example of the correct balance between government and market regulation in a capitalist economy. Too much regulation is as bad as too much deregulation, as seen in the savings and loan crisis and, more recently, Enron. Somewhere between regulated and unregulated markets is the ideal point, or "fair market," representing the optimum balance between consumer and industry interests.

There are many reasons why CRA is an example of a fair market regulation:

- By providing credit access to all, it gives everyone an equal chance at (but no guarantee they will get) their share of the American Dream.
- It is needs-, not race-based, with the focus on the most needy low- and moderate-income groups.
- It does not require banks to make bad loans or lose money.
- While banks pay a reasonable compliance cost, there is little to no cost to taxpayers, who get something in return for federal subsidies to the banking industry.
- The law has more bark than bite in terms of actual enforcement and is therefore not overly intrusive to business.
- It relies more on the positive power of disclosure in the market than on regulatory brute force.
- It is reformed periodically so that it remains responsive to both consumer and industry interests.

The rules and regulations implementing CRA as developed, applied, and enforced by the federal bank and thrift regulators are being reformed this year as part of a mandatory review of this law. Their last major reform in 1995 resulted in what was called the "new CRA," and banks and thrifts have been operating under those rules and regulations since that time. The revisions now being drafted are based on the regulators' review of approximately 400 public comments received in October of 2001 and should be released sometime during the second half of 2002.

The future of CRA depends upon the direction of these reforms. To create optimal public policy, bank and thrift regulators must reach the ideal balance between competing consumer and industry interests. This brief presents the first comprehensive analysis of the public comments,and concludes with specific recommendations that will lead to optimal CRA reform.

CRA Battlegrounds

The CRA was shepherded through Congress in 1977 by Senator William Proxmire of Wisconsin.[2] The law is elegantly simple: it encourages (not requires) federally insured banks and thrifts to help meet the credit needs of their entire communities, including low- and moderate-income (LMI)[3] neighborhoods, consistent with safe and sound banking practices. This means that,in theory, everyone has an equal opportunity to apply for and,if necessary, be denied credit. Access to credit, which can almost be argued to be an inalienable right, has no guarantees other than a fair chance to be accepted or denied based on a bank's underwriting practices.

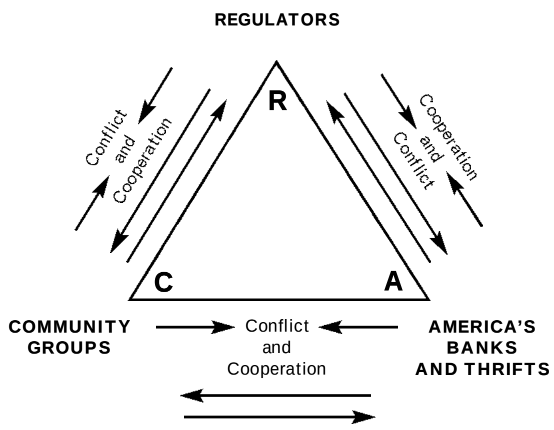
In passing the law, Congress determined that regulated financial institutions are required to serve the convenience and needs of their communities, which include credit services as well as deposit services. To ensure that they do, Congress directed the bank and thrift regulators to periodically assess each institution's record of meeting community credit needs,and to consider that record when acting on deposit facility branch or other expansion applications. These regulators include the Federal Reserve (Fed) and the Federal Deposit Insurance Corporation (FDIC) and two agencies of the Department of the Treasury, the Office of the Comptroller of the Currency (OCC) and the Office of Thrift Supervision (OTS). This approach afforded community groups the opportunity to hold up branch, merger, and other expansion applications while they persuaded regulators to mandate changes in a bank's credit practices, a tactic that sometimes resulted in grants to the protesting groups. Opponents of CRA labeled such practices as nothing more than "legalized extortion." In the early years, there was no middle ground: you were either with the banks or with the community groups. This, like almost everything else, changed over time.

The CRA Triangle

What quickly developed was a model of consumer, government, and business interaction known as the "CRA Triangle" (Thomas 1993, 1998). As seen in Figure 1, an ongoing and often volatile dynamic tension exists among its three elements or "corners":

1. Community groups, representing consumer interests
2. Regulators,influenced and monitored by Congress and the Administration, representing the interests of the "public"
3. America's banks and thrifts subject to CRA (excluding credit unions), representing the interests of their stockholders

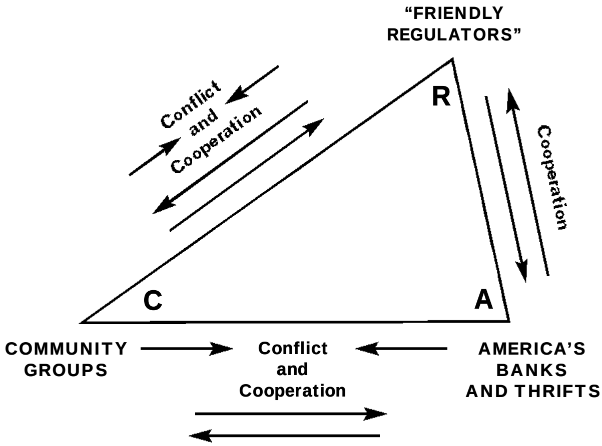
Figure 1 The CRA Triangle



The CRA Triangle in Figure 1 represents an ideally balanced and proportioned model with three equal sides and angles where none is more important than another. Community groups and banks together form the base, with regulators in the middle position, equidistant to both corners. In this ideal model, the regulators act as impartial referees between community groups and banks, attempting to fashion a "socially optimal" result benefiting both parties. The reference to optimal public policy in CRA reform is based on reaching the ideal balancing point through consideration of potential conflicts of interest, pressures, and other factors impacting each of the triangle's corners.

A triangle must have three corners and three sides, but these are not always equal. The "Friendly Regulator Hypothesis" (Thomas 1993, 1998) states that regulators have become far too close to the banks they supposedly regulate and sometimes act more like cheerleaders than impartial referees, promoting one team (the banking industry) over another (consumers).[4] I have identified the Fed as the quintessential friendly regulator (Thomas 1993, 1998), and Figure 2 depicts the resultant "Fed-distorted" CRA Triangle. This has the friendly regulator cooperating quite closely with the banks; both of these corners are significantly isolated from consumer interests. A similarly distorted triangle can exist when community groups get too close to the banks providing them funds.

Figure 2 **Fed-Distorted CRA Triangle**



While it is normally assumed that each corner will act in the best interests of its constituent group, this is not always the case. CRA reform would certainly benefit if they did so, while avoiding the "Top Ten New CRA Mistakes" displayed in Table 1 (Thomas 1998). These CRA mistakes are just as relevant now as they were during the last CRA reform. Even if each corner truly represents its constituents' interest, there may be constraining factors. Just as banks are under stockholder and regulatory pressure, the regulators themselves may be under congressional scrutiny, especially in a financially struggling agency undergoing budget cuts. Community groups, too, can be the subject of congressional scrutiny that can change the way they operate and obtain funding. The continuous conflict and cooperation among the three corners of the balanced CRA Triangle represents the dynamic tension that keeps the structure strong.

Past Reform Proposals Still Relevant Today

One of the beauties of CRA is that it is periodically reformed to keep it current and responsive to the needs of both communities and banks. This year's reform, on the law's 25th anniversary, is the second scheduled after the first major effort, which resulted in December 1993 and September 1994 proposals prior to the May 1995 final "new"CRA regulations. Table 2 compares the original or "old" CRA regulations to the December 1993 and September 1994 "new"CRA proposals and the final, May 1995, "new" CRA regulations. Table 3 compares the assessment factors and performance standards of the "old" CRA regulations and the May 1995 "new" ones. (Tables 2–6 appear near the back of this Brief, beginning on page 36.) While the 2002 reform will possibly require multiple proposals, the number of current comments relative to those submitted during the last reform (see below) does not suggest that this will be the case.

Regulators realized during the last reform effort that they might not get everything "right." They consequently built in a required reform in 2002, which would give at least five years of experience with all aspects of the new CRA (transitioned in during 1996 and 1997).[5] Now, with this experience, those parts of CRA that encourage access to LMI credit can be improved upon, and those that do not can be eliminated or modified.

In an earlier work (Thomas 1993), I made numerous recommendations to reform CRA,many of which were adopted in the 1995 final reform effort. I subsequently restated and argued the need for those recommendations that were not adopted (Thomas 1998).

Table 1 Top Ten New CRA Mistakes in the CRA Triangle

Top Ten New CRA Mistakes by Community Groups

1. "Selling out" by publicly supporting mergers of banks that have "bought" the group (and its integrity)
2. Using direct or indirect "extortion" techniques to obtain direct or indirect funding for a community group in exchange for not protesting a merger or other activity
3. Being the first "ambulance-chasing" community group to rush in to "cut a deal" with a big bank announcing a merger and then publicly supporting it
4. Not publicly disclosing all direct and indirect sources of funds (hard and "soft" money) from a bank or its affiliate
5. Indiscriminately attacking all banks as being "bad guys," without making a legitimate attempt to identify the good and truly outstanding CRA banks that are making a difference
6. Focusing exclusively on CRA and fair lending issues without being mindful of the public policy implications of critical "big-picture" financial institution topics
7. Concentrating on minority rather than LMI lending data in CRA (as compared to fair lending) analyses
8. Not taking a serious stand challenging a merger or other bank activity which the group truly believes is counter to the public interest
9. Representing oneself as a community group activist or leader when the real goal is personal advancement or some other non-community agenda
10. Failing to organize and support a truly independent and non-industry funded national bank consumer advocacy organization

Top Ten New CRA Mistakes by Regulators

1. Forgetting that federal bank regulators must first and foremost "regulate and enforce" the (CRA) law
2. Getting far too close and friendly to certain banks
3. Misallocating resources among the four regulators
4. Engaging in a CRA "competition in laxity" with other regulators
5. Allowing personal subjectivities to cloud and sometimes cover up the facts
6. Permitting the ultimate new CRA loophole of approving any "certain special purpose bank" CRA exemption
7. Falling into the credit allocation and unnecessary government intervention trap by requiring higher and more lending and other goals for strategic plan approvals.
8. Instead of doing too little in the area of CRA and fair lending enforcement, going off the deep end by doing way too much

9. Forgetting the focus of the new CRA on LMI borrowers vs. areas and very small (below $100,000 in revenues) and small businesses and farms vs.mid-sized and large ones
10. Ignoring the principle of “fair banking” in the merger process

Top Ten New CRA Mistakes by Banks

1. Spending more time on CRA “bashing” than CRA compliance
2. Choosing the strategic plan option or failing to withdraw a plan once it has been submitted
3. A small bank, even one with low loan-to-deposit or other ratios, choosing anything but the streamlined small bank exam
4. Truly special-purpose banks failing to apply for a limited purpose bank (LPB) or wholesale bank (WB) designation
5. Not preparing an internal self-assessment using the detailed new CRA exam procedures
6. Improperly “managing” the new CRA exam process
7. Inappropriate handling of legitimate CRA public file requests
8. Not integrating the Qualified Investment test into the bank's overall investment and corporate contributions plan
9. Misallocating compliance budgets
10. Letting CRA “run the bank” instead of running the bank according to its business plan and complying with CRA

Source: The CRA Handbook (McGraw-Hill, 1998).

Proposed 2002 Reform Process

The July 19, 2001 Federal Register notice of the Advance Notice of Proposed Rulemaking (ANPR) for the reform of the CRA regulations begins by raising some fundamental general issues about the need for and overall approach to reform ("Proposed Rules" 2001). It then identifies eight specific issues for comment:

1. Large Retail Institutions: Lending, Investment,and Service Tests
2. Small Institutions: The Streamlined Small Institution Evaluation
3. Limited Purpose and Wholesale Institutions: The Community Development (CD) Test
4. Strategic Plan
5. Performance Context
6. Assessment Areas
7. Activities of Affiliates
8. Data Collection and Maintenance of Public Files

Prior to the last reform effort there was only one CRA exam for all types and sizes of banks, rather than the four identified above (items 1–4), and the performance context concept (item 5) did not exist. More importantly, the last reform effort created the investment and service tests (weighted 25 percent each) in addition to the basic lending test (weighted 50 percent). These two new tests, now accounting for 50 percent of the CRA rating, are required for large retail banks but optional for small ones.

The comment period for the current CRA reform process closed on October 17, 2001. The four bank and thrift regulators received approximately 400 different comments, only 6 percent of the 6,700 comments received during the first (December 1993) reform effort. This suggests either satisfaction with the current regulations or relative indifference or, more likely, some combination of the two.

CRA Reform Comment Analysis

For this study, I made multiple Freedom of Information Act (FOIA) requests of the four bank and thrift agencies for all submitted comments. (While the OTS was the only agency to provide these comment letters online, the other regulators seem to be moving in that direction.) Almost all of the comments came from either community groups or the bank and thrift industry. With the exception of a few members of Congress and other government agencies, the regulators did not submit comments. Again, from the perspective of the CRA Triangle, the regulators are acting as referees or perhaps arbitrators to come up with the socially optimal reform proposal that will best meet public policy goals.

The comments were reviewed, categorized as from either a community group or the industry, and summarized with respect to the most common elements of the two views. A common profile quickly developed, oftentimes the result of the views of the most prominent community groups and industry trade associations. Some national organizations on both the community group side (such as the National Community Reinvestment Coalition and the Woodstock Institute) and bank side (such as the Independent Community Bankers of America) circulated what were essentially form letters, which added to the quantity but not the quality of comments. Two tables were prepared using the submitted comments of the most prominent and representative community groups and industry associations, as well as those of a few individual financial institutions. Table 4 summarizes 10 industry views on CRA reform, mainly those of trade groups with a few individual financial institutions. Table 5 presents a comparable tabulation of 10 views from the most prominent community groups.

The 20 tabulation summaries in Tables 4 and 5, while accounting for just 5 percent of the roughly 400 total comments, are quite representative of the overall community and industry views. Using the respective community and industry profiles adopted in this analysis, in addition to the input from the remaining comment letters, the optimal reform strategy was developed as being the one most responsive to both of these corners of the CRA Triangle. Table 6 summarizes the specific optimal reform recommendations for CRA. I previously had made many of these (Thomas 1993, 1998), and several have been discussed elsewhere (Thomas 2001a).

Regulatory Interest in the Investment Test

The first public proposal from a regulator to eliminate the investment test came from former FDIC chairman Donna Tanoue, who suggested replacing it with a new community development test (Heller 2000). While the OCC was the bastion of CRA regulatory intelligence during Eugene Ludwig's tenure as comptroller, this function switched to the FDIC when the OCC's well-respected CRA guru, Steve Cross, became head of the FDIC's Division of Compliance and Consumer Affairs in May 1999. The managing director of the OTS compliance function and top compliance people from other agencies joined Division Director Cross the following year. Since the FDIC was the new CRA regulatory brain trust, this agency's position on replacing the investment test was well thought out and responsive to both consumer and industry interests.

While other regulators have generally been silent on the controversial investment test, the Federal Reserve Bank of San Francisco has established and aggressively promoted an entire investment test infrastructure, generally perceived as being supportive of this test. For example, its Community Affairs department has six separate community investment specialists who put on a series of quarterly roundtables throughout the West. It has its own *Community Investments* publication, the March 2002 special edition of which, "A Guide to Community Development Investments," contains articles by several nonprofit and for-profit investment test vendors and their contact information (Federal Reserve 2002). These and other vendors have appeared at numerous Fed-sponsored CRA events to promote qualified investments, and many have been successful in this regard with banks and thrifts in that region. Unlike most of the other Federal Reserve banks, San Francisco's has a more pro-industry than pro-consumer reputation (Thomas 1998).

This background is relevant to the extent that the Fed's investment test infrastructure serves as a motivation to maintain the status quo. If there is no investment test or, alternatively, a significantly reduced one, is there a need for the San Francisco Fed's glossy *Community Investments* magazine or their community investment conferences? What about their community investment specialists, the most senior of whom probably developed valuable contacts in the banking and securities industries? Good public policy by Federal Reserve bank regulators dictates that their one and only concern be what is in the public interest, giving appropriate consideration to both consumers and the industry alike. The Fed's position on CRA reform should not be influenced by their San Francisco bank's significant investment test infrastructure.

Similar potential conflicts may exist in some very large banks that have likewise built up significant investment (and service) test infrastructures. What if an employee was hired because of expertise and contacts in these specific areas that now might be eliminated or greatly cut back? Again, stockholder rather than employee special interests should dictate bank policy on the investment or service tests, and regulators must consider the source of all comments.

Elimination of Investment and Service Tests

Many large banks and bank trade associations are rightfully asking that CRA be returned to its LMI lending roots by abolishing the investment test and, to a lesser extent, service test experiments, or at least making them optional as is presently the case for small banks. Community groups generally want to keep everything in CRA and add new requirements. They are loathe to admit that any part of the law or its implementing rules and regulations cannot be cost-benefit justified, as the apparent goal is to increase, not decrease, the coverage and scope of the law. This can, however, be counterproductive since the extraneous investment and service tests reduce by 50 percent the weight given to LMI lending. For this reason, good public policy dictates that these two tests be reduced to individual performance evaluation factors under the lending test, as long as they can be documented as LMI credit related (see Table 6). At some point,these two tests could even become optional to improve a Satisfactory rating, as is presently the case under the streamlined small-bank exam.[6]

Reduce Grade Inflation by Removing Two of Three Inflated Tests

The most comprehensive CRA grade inflation analysis of actual large-bank exams revealed that fully 71 percent of the ratings on the investment test were inflated by one grade, compared to 32 percent and 29 percent comparable inflation rates for the lending and service tests, respectively (Thomas 1998). Thus, the investment test is a primary cause of overall CRA grade inflation.

Several government agencies have examined inconsistency and other problems associated with CRA exams and ratings (see U.S General Accounting Office 1995 and Office of Inspector General 1998), but have not, perhaps for political reasons, broached the highly controversial issue of grade inflation. This practice changed, however, with an OTS December 21, 2000 internal evaluation of public performance evaluations (PEs), which was "unable to validate the appropriateness of the investment component ratings" for 41 percent of its sample (see Office of Inspector General 2001).[7] Regarding the investment test, the OTS study found "apparent rating inconsistencies" as well as "limited instances where the investments component may have been rated higher than warranted." The analysis concluded with 10 very useful recommendations to ensure that PEs provide accurate performance assessments. The optimal public policy reforms advocated in this brief adopt them all (see Table 6).

There is a general consensus that grade inflation, not just of individual tests but of overall ratings, is a serious concern. One remedy generally advanced by community groups is to make both the investment and service tests much more quantitative and rigorous, often with new ratios and guidelines. This, however, would result in an additional burden not just for banks and thrifts, but also for regulators,some of whom are facing budget cuts.

The optimal solution to reducing grade inflation with these two tests is not to expand their data and analysis but to eliminate them by converting them into separate performance rating factors under the key lending test. These tests will be appropriately counted to the extent that they benefit LMI credit, but not at a morbidly obese 50 percent of the final rating.

The service test includes both retail banking and CD services.One reason for the considerable inflation in this test is the fact that every bank, a "financial services" business by definition, provides some sort of retail banking service and is therefore entitled to some credit. Many banks make no qualified investments, and some make few if any loans during certain review periods. But every bank, including Internet banks, offers some retail banking service under the terms of its charter.

Another problem with the service test is the confusion that sometimes exists between its main retail banking and community development (CD) components. CD services are often subjectively defined by examiners. CD and retail banking services that can be documented to encourage access to and provision of LMI credit are useful and deserve credit. But allowing 25 percent of a bank's CRA rating to be determined by services effectively dilutes the lending test.

For the above and other reasons, CD and retail banking should be folded into the lending test as separately evaluated factors, but only if they can be documented to be LMI credit related. Under this proposed reform, banks and community groups involved in LMI credit-related activities will still benefit, but not to the same degree.

Community Groups Potentially Conflicted in Defending Investment and Service Tests

Community group attempts to defend the nonlending tests are not only unrealistic but also somewhat self-serving. In the case of the service test, some groups benefit by acting either directly as a beneficiary of some CD services or indirectly by being compensated by banks for performing such services (for example, home ownership counseling to LMI homebuyers). This is a relatively minor concern compared to the investment test, which some groups have significant financial incentives to maintain. Bank contributions to community groups count as qualified CRA investments, and the groups may feel this source of funding will be reduced or perhaps even eliminated without a stand-alone investment test.

There would be an even greater incentive to defend the investment test in the case where a major national community group and a for-profit CRA investment firm have an interlocking Board of Directors and a "logrolling" arrangement where each promotes its affiliation with the other in newsletters and websites in addition to having a formal agreement that relates community group funding to CRA investments sold. To defend a questionable test that can financially and otherwise benefit community groups is one thing, but to propose new grant-measuring ratios or award bonus credits for grants as some groups have done is pushing the envelope. Community groups should realize that they received grants from banks before the investment test and will continue to receive them even if that test is eliminated or greatly reduced in scope.

The main defense of the investment test by community groups is an oft-repeated 1999 quote from Fed Chairman Greenspan stressing the need for greater "equity" investment in small businesses in lower-income communities (Greenspan 1999). This is, unfortunately, somewhat misleading, as most CRA "qualified investments" under the investment test are not of this type but rather purchased and repurchased LMI, mortgage-backed securities (MBS) or even certain municipal bonds and minority bank certificates of deposit. This is a very important distinction, because true equity investments as referenced in the Greenspan quote are the exception rather than the rule.

"Community Enrichment Act"

An entire CRA investment industry has been created by Wall Street to take advantage of the shortage of qualified investments, which are so in demand that there is now a "CRA premium." The problem is that many of the Wall Street opportunists who have moved into CRA are more interested in profiteering from CRA investments than increasing LMI credit. This is not surprising: it happens whenever Wall Street meets Main Street.

Many other CRA profiteers are getting rich from the investment test (Kellner 2001). Unfortunately, their activities have resulted in few visible improvements to LMI credit access (Thomas 2002b). The current investment test has led to many "qualified investments" that merely recycle existing ones while creating no new underlying LMI loans. One LMI loan may be bought and sold many times and then securitized and repeatedly traded as an MBS. Since it is defined as a "qualified" CRA investment, many banks get CRA credit for one underlying LMI loan.

While investment test vendors and even their banking clients will argue that such activities "enhance access to LMI credit," this is not unlike their Wall Street brethren churning a portfolio for commissions. Some MBS have been churned so much by the investment test that the underlying LMI purpose of the original loan and CRA are long forgotten. A community banker originating an LMI loan may remember the property location and perhaps the name of the family. MBS purchasers only remember the amount of CRA premium paid to the securities broker and how much credit they received from the CRA examiner. All of this is the result of the investment test created in the last CRA reform.

The Proposed Streamlined Exam for Large Banks

The streamlined small-institution evaluation has been quite popular with the industry, although persistent grade inflation has been a continued problem. The exam is totally focused on lending and includes specific LMI ratios; the optional investment and service tests may allow a Satisfactory rating at a small bank to be increased to an Outstanding one.

There is no question that the small-bank streamlined exam is less of a regulatory burden than the comparable large-bank retail exam. According to an October 17,2001 CRA reform comment by the California Bankers Association, one member bank that had recently graduated from the small- to the large-bank exam experienced over $50,000 in additional costs unrelated to the investment of new dollars or services in its community.

One of the goals of good CRA public policy is to streamline the large-bank exam as much as possible. The optimal CRA reform, as seen in Table 6, eliminates two of the three current tests, with the result that the new lending test counts for 100 percent rather than half of the overall CRA rating.

The 1995 revised CRA regulations make an important distinction between the performance criteria within each test and the factors within the performance ratings matrix used by examiners. The lending test contains five performance criteria and seven rating factors. Since there are five possible ratings in its performance ratings matrix,there are 35 possible cells. By comparison, the investment test contains four performance criteria and three factors in its 15-cell ratings matrix, while the service test has six criteria and four factors in 20 cells. Thus,there are a total of 70 possible cells in all three large-bank exam matrices.

The CRA currently specifies five performance criteria for the lending test:lending activity, geographic distribution, borrower characteristics, CD lending, and innovative or flexible lending. The proposed streamlined exam for large banks would include eight criteria. The first four would remain the same, but the fifth would be replaced by “Qualitative LMI lending characteristics.” This factor would also include consideration of any predatory or other adverse credit factors that would affect LMI people or areas, small businesses, or farms. Conversely, a bank would be given additional credit for graduating qualified LMI subprime customers into prime ones. The three new evaluation criteria would be investments, CD services, and retail banking services that can be documented as helping to meet the credit needs of LMI people and neighborhoods as well as small businesses or farms.

Thus, the proposed streamlined large-bank exam summarized in Table 6 would include the following eight performance criteria:

1. Lending activity
2. Geographic distribution
3. Borrower characteristics
4. CD lending
5. Qualitative LMI lending characteristics
6. LMI credit-related investments (replacing the investment test)
7. LMI credit-related CD services (replacing the CD portion of the service test)
8. LMI credit-related retail banking services (replacing the retail banking service portion of the service test)

The actual lending test performance ratings matrix from the 1995 regulations divides geographic distribution into two items and adds a criterion dealing with loans to the highly economically disadvantaged, for a total of seven performance rating factors.Likewise, the proposed streamlined large-bank exam would convert the eight new criteria into the following 10 ratings factors:

1. Lending activity levels responsive to assessment area (AA) credit needs
2. Percentage of loans in AA
3. Borrower distribution by income and business/farm size in AA
4. Geographic distribution of loans in AA
5. Lending to highly economically disadvantaged geographies and low-income people and very small businesses in AA
6. Qualitative LMI lending characteristics
7. CD lending activities
8. LMI credit-related investments
9. LMI credit-related CD services
10. LMI credit-related retail banking services

The resultant matrix,published in each PE, would have these 10 factors times five possible ratings, for 50 possible cells. While an explicit weighting scheme for the different factors would result in a more quantitative approach, the performance context and related exam factors should determine the appropriate weighting. As noted in Table 6, the overall CRA rating would now be one of five rather than four possible ratings. Table 6 also contains specific recommendations regarding performance evaluation procedures, such as a time-sensitive evaluation (and pro rata weighting) over the review period and limited (pro rata) credit for CRA-qualifying activities commencing within six months of an exam's starting date.

The proposed exam would be streamlined for both large retail banks and examiners alike, because it would involve one rather than three tests (a reduction of 67 percent); 10 rather than 15 performance criteria (a 33 percent reduction); one rather than three performance ratings matrices (a 67 percent reduction);and 50 rather than 70 individual rating matrix cells (a 29 percent reduction). Those large banks with extensive CRA investments and services would continue to garner credit under this streamlined exam, as long as they were legitimately LMI credit related. In the event that grade inflation and other problems associated with the investment and service tests continue,the tests could become optional factors as is presently the case with the small-bank exam. Although this would allow for a smooth transition,the investment and service tests might ultimately have to be eliminated.

Expansion of Definition of "Small" Banks to Qualify for Streamlined Exam

The number one CRA reform priority for small banks is to increase the minimum allowable size by which they can qualify for the streamlined exam. Community groups are against such increases. Currently, a small bank is defined as an independent institution with assets of $250 million or less or an affiliate of a holding company with less than $1 billion in assets. The streamlined test represents a significant time and cost savings compared to the large-bank exam.

As seen in Table 4, most bank trade groups would increase the former number to at least $1 billion and either remove the latter requirement or increase it to as much as $5 billion. Community groups, on the other hand, as seen in Table 5, would keep this definition unchanged and even make the exam less streamlined. The optimal solution from a public policy perspective is to double the current independent minimum asset level to $500 million,a number commonly associated with a "community bank" in today's competitive environment. The comparable holding company minimum should likewise double to $2 billion.

The proposed $500 million and under definition for a community bank has been used by many regulators. For example, a recent Fed article (Hall and Yeager 2002) noted, “Community banks are typically smaller banks; most have fewer than $500 million in assets.” An OCC economist (Whalen 2001) used the same dollar range to define a community bank. In fact, when responding to the CRA regulators, several small banks and thrifts departed from the boilerplate letter circulated by their national trade groups and recommended a $500 million and under rather than $1 billion asset level as a reasonable definition of a small bank.

Probably the most compelling argument in favor of this definition is the fact that it would encompass about 90 percent of the nation’s nearly 10,000 banks and thrifts, compared to the roughly 80 percent covered with the $250 million and less definition. Assuming the previously cited $50,000 regulatory cost of graduating from a small to a large retail bank is accurate, the approximately 1,000 banks and thrifts in the $250–500 million asset range would have some $50 million available for community reinvestment or other purposes. Making the quantum leap to $1 billion and less would take in nearly 95 percent of the industry, hardly a reasonable basis for a small/large size distinction. The fact that the large-bank exam would be streamlined under these reform recommendations might somewhat reduce the urgency of being designated a “small” bank. Good public policy should not result in significant differences in compliance burden based solely on size.

Misguided Community Group Proposal to Make CRA Race-Based

Community groups are flat-out wrong to ask that CRA become race-based, something that could jeopardize the future of this needs-based law. Nothing could be more damaging to CRA than to change or even redirect its primary focus away from LMI lending. Most leading community groups have explicitly called for a race-based CRA in addition to its statutory needs-based (LMI) history. Even some respected researchers have apparently confused the Act’s statutory intent by frequently mentioning “minority” communities alongside “lower-income” ones in their discussions of CRA (“25th” 2002).

The National Community Reinvestment Coalition (NCRC), one of many Washington, D.C.–based community groups, wants minorities to be explicitly considered on the lending test just as LMI people and areas are. The Greenlining Institute argues in its October 15, 2001 CRA reform comment that "CRA exams should not be colorblind," citing the large percentage of minorities in California. What neither community group mentions, however, is the fact that California, the most heavily populated U.S.state, is now "majority-minority" according to the 2000 Census, which means that over half (51 percent to be exact) of its residents are designated minorities, specifically Latinos, Asian Americans, African Americans, and Native Americans (Muñoz 2000). Census Bureau data analyzed by the Center on Urban and Metropolitan Policy at the Brookings Institution found that 52 of the 100 most populous cities in the United States are majority-minority (Schmitt 2001). In fact, some demographers have suggested that the entire nation will be majority-minority at or shortly after the midpoint of the 21st century.

Within a majority-minority state or large city, a race-based CRA proposal would lessen the public policy benefits of the law. This is because limited resources would be diverted from the neediest people and areas to those that may or may not be in need, but are associated with a certain ethnic group. Just as was the case with affirmative action programs, this would make CRA more controversial than ever and more than likely reduce its strong bipartisan support. CRA has survived for 25 years as a race-blind law, and any changes in this regard could jeopardize it.

The banking industry would likely not even consider amending CRA to become race-based, although some segments have proposed deviating from its LMI-based focus. Wachovia Corporation, for example, in its October 17, 2001 CRA reform comment, proposed that the "community development" definition be expanded to include all such projects rather than only those in LMI areas. This misguided proposal, like the race-based idea from community groups, would likewise serve to undermine the needs-based foundation of CRA.[8]

Subprime vs. Predatory Lending Issues

Community groups are also playing with a two-edged sword in their efforts to heavily regulate subprime lending to root out predatory problems. This is because many community group leaders fail to distinguish between subprime lending, which is "good," and predatory lending, which is not. For example, the head of a national coalition tied the two concepts together in past congressional testimony by expressing concern over the exponential growth of "subprime (and potentially predatory) lending" (NCRC 2000). Another national community group issued a study lambasting predatory lending and "financial apartheid," but all of the supporting data referred to subprime loans (ACORN 2000).

Even worse are those who would criticize others merely for being associated with a subprime product. This was the case with a community representative turned professor whose Ph.D. dissertation on CRA (Metzger 1999) attacked a prominent housing finance professor for his "ties to the subprime industry," due to his association with a firm that sells mortgage origination software to prime and subprime lenders alike!

Some community groups even propose penalizing banks that do legitimate subprime lending. For example, the October 2, 2001 CRA reform comment by the NCRC states that "subprime lending must not count as much as prime lending." The October 15, 2001 comment of the California Reinvestment Committee reports that its members "overwhelmingly state that financial institutions should receive little to no credit for subprime lending."

This confusion between predatory and subprime lending and, worse yet, stigmatizing of the latter may have the perverse impact of limiting the availability of credit to CRA's target group—LMI individuals and areas—where subprime lending is important. Well-meaning public officials, under pressure from vocal community groups,may be throwing the CRA baby out with the predatory bath water. This is not good public policy.

The Fed has attempted to clarify the distinction between subprime and predatory lending: "Just as the expansion of subprime lending has increased access to credit, the expansion of its unfortunate counterpart, predatory lending, has made many low-income borrowers worse off" (Gramlich 2000). A joint report by two federal departments on predatory lending made the same conclusion: "Subprime lending serves an important role, by providing loans to borrowers who do not meet the credit standards for the prime mortgage market. Some borrowers in the subprime market, however, may be particularly vulnerable to abusive lending practices" (HUD 2000).

Not all community groups confuse subprime and predatory lending. The Neighborhood Reinvestment Corporation, a public nonprofit established by Congress, identified still another problem with the wholesale condemnation of subprime lending in its October 17, 2001 CRA reform comment: "We would stress. . . that discouraging regulated institutions from directly or indirectly engaging in subprime lending could prove counterproductive. Regulated institutions are more likely to provide the service in a responsible manner," as opposed to unregulated institutions, some of which are "totally unscrupulous" according to this source.

Another community group that has apparently seen the light on subprime lending is the Greenlining Institute. An article about Washington Mutual, the nation's third-largest subprime mortgage lender, quotes Greenlining's legal counsel as saying, "Our position from the beginning has been that we want every major regulated bank doing subprime" (Mandaro 2001).

The community corner of the CRA Triangle has influenced most of the public policy involving subprime and predatory lending, including numerous city, county, state, and federal actual and proposed antipredatory laws. Unless the subprime lending industry develops a unified voice and improved image for its "high risk" lending product, public policy, including possible federal preemption of local and state antipredatory laws, will continue to be weighted against the industry (Thomas 2001b). Such a failure of the CRA Triangle will not result in good public policy.

It makes sense that the qualitative aspects of LMI lending be evaluated in the context of a CRA exam (see recommendation in Table 6). Those banks and their affiliates that can, for example, document a significant effort to move qualified LMI subprime borrowers to the lower-cost prime market, should receive credit under this qualitative factor. Those carrying loans deemed to be predatory would be downgraded. Contrary to the position of most community groups, this analysis should not include any race-based factors, which are the province of fair-lending exams.

Assessment Area Definition

Banks and thrifts generally prefer assessment areas (AAs) to be as small as possible, while community groups (and oftentimes regulators) take the opposite view. A larger AA means that loan, investment, and service performance will be evaluated for an expanded area. This can be costly for banks and thrifts but advantageous to community groups in the expanded areas, if they can then benefit from additional grants (such as a "qualified investment" under the investment test).

Banks and thrifts are generally happy with the current AA approach,as they have the flexibility to define this key geography with but a few constraints. Community groups, on the other hand, would eliminate some of this flexibility, especially for Internet and other banks with alternative delivery systems, where the groups feel a national AA might be appropriate. These banks and others using the mail, telephone, or brokers to extend credit often have pockets of borrowers all over the country, but just a small percentage (often 15–25 percent or less) from within its AA, typically narrowly defined around its legal residence. Such banks are penalized in their CRA exams due to the low percentage of lending in their AAs, but local geography is not the most relevant concept for such banks.

We must keep in mind, however, that such banks are relatively few in number, excluding those legitimately covered under the limited purpose and wholesale bank test. Although there was much hype about Internet banks during the dotcom era, only a handful remain; some have failed, while others have opened traditional brick-and-mortar branches.

It is not good public policy to establish a new AA regulatory framework based on the special circumstances of a relatively small number of fairly new and oftentimes struggling banks, as the new regulations will most likely prove an undue burden for all banks. Some community groups have proposed that Internet and similar banks define their AAs on the basis of their lending market share in local markets, using a very small 0.5 percent minimum criterion. Assuming this is a reasonable approach, the relevant cutoff would have to be significantly higher, perhaps 5–10 percent or more, before the subject bank's relative performance had a meaningful impact on the local credit market.

Another suggestion for evaluating the performance of Internet banks is to evaluate their performance under the CD test as originally proposed by the OTS. This proposal had appeal when it appeared that they might become so popular as to justify their own special purpose category, as had limited purpose and wholesale banks. However, the actual experience with this exam suggests that it be reserved for truly special purpose banks that are not retail ones.

Based on the small number of pure Internet banks, it makes more sense to evaluate them as the retail banks they are, but give them credit for any LMI-related activity outside of their AAs as long as they are meeting local LMI credit demand. This same approach can be applied to any bank with a non-traditional delivery system. Thus,this recommendation would maintain the AA status quo but require examiners to report on the LMI loan characteristics of such a bank's entire portfolio, regardless of its location. This means that even if an Internet or other nontraditional bank made a very small percentage of its loans in its defined AA, the proper performance context analysis would result in a lower weighting of the AA loan percentage rating factor relative to other performance factors, especially nonlocal LMI lending. The examiner evaluating the LMI borrower and geographic characteristics of the nonlocal lending would give appropriate credit for such CRA lending regardless of where it occurred. This would be similar to the recommended approach under the CD test of giving CRA credit for LMI-related CD activities anywhere, even if outside of the AA or broader statewide and regional area. The bottom line should be CRA credit for any legitimate LMI credit-related activity, regardless of location, as long as local LMI credit needs are first being met.

Elimination of the Strategic Plan Option

The last CRA reform effort created the strategic plan option for all types and sizes of banks. It is good public policy to eliminate regulations such as this, which have few benefits relative to significant costs and uncertainties (Thomas 1998). Eliminating this ill-conceived option would result in additional streamlining by reducing the number of possible exams from four to three. While most banks would rather keep the strategic plan option in their CRA regulatory closet for possible use, very few have selected it.[9] It is somewhat ironic that the banking industry would favor a reduction in the regulatory burden but nevertheless insist on keeping a rarely used and controversial CRA regulation on the books.

Community groups are generally in favor of keeping this or any existing part of the regulations, but few have conducted an objective evaluation. One of the exceptions is NCRC, which in its October 2, 2001 CRA reform comment argues for the elimination of the strategic plan option: "It has been abused too often; banks declare easy goals and examiners approve these goals." Note, however, that the group is proposing the elimination of an option that some of its members championed during the 1993–95 reform process. In fact, one of that group's directors was reportedly responsible for suggesting or promoting this option to the regulators. A recent proposal by representatives of both NCRC and the Greenlining Institute to expand CRA to insurance providers even called for "strategic community investment plans" among their suggested new requirements (Gamboa and Taylor 2001).

Improvement of Public Performance Evaluations

I made a number of specific recommendations to improve PEs for each of the different types of CRA exam (Thomas 1998). A recent analysis by the Office of the Inspector General of the OTS made 10 recommendations to improve the quality of its PEs (OIG 2001), most of which were identical to those I previously suggested.

Good public policy would dictate that each of the following OTS recommendations for PEs become mandatory for all agencies as part of the current CRA reform:

1. Better ensure complete and full disclosure as to how examiners evaluate each component area in arriving at the component ratings.
2. Seek, through Federal Financial Institutions Examination Council (FFIEC) interagency deliberations, further regulatory guidance as to how an institution's CRA performance is to be considered and weighed in the application process.
3. Consider establishing internal written guidance to better ensure that CRA performance is taken into consideration in a consistent and uniform manner in the application process.
4. Ensure that performance context information is appropriately incorporated into the PE report.
5. Seek, through FFIEC interagency deliberations, to establish more objective regulatory criteria as to how investments are to be assessed.
6. Provide for quality assurance reviews of CRA examinations, to include a broader analysis comparing inter- and intraregional examinations and PE reports for consistency.
7. Seek, through FFIEC interagency deliberations, to establish objective criteria and/or clarification as to what constitutes strong lending and CD lending when these activities are used in support of a Low

Satisfactory investment rating for thrifts with few or no qualifying investments.

8. Improve controls to better ensure that examiners contact community groups and that the results of these contacts are more fully described in the PE report.
9. Assess the value of requiring a comparison of thrift lending relative to assessment area demographics to enhance the performance context of a thrift's lending.
10. Provide examiners with further guidance to ensure greater consistency in applying the agency's approach to nontraditional thrifts.

Need for Specialized Compliance Examiners and Exams

The topic of specialized compliance examiners and exams relative to those for safety and soundness at two of the four regulatory agencies has only recently become a public policy issue in banking. The primary motivating forces are budget cuts in the case of the OTS, and efforts to reduce the regulatory risk burden in the case of the FDIC. While budget or regulatory burden cuts could occur anywhere within these two agencies, it appears that the compliance and CRA areas may be most adversely affected.[10] In this case, good public policy is undermined to the extent that "friendly regulators" are acting more in the industry's interest rather than that of consumers.

The FDIC's program (2002) was euphemistically titled "Reducing Burden on Banks and the Public." It appears, however, that all of its proposed reductions focus on banks and benefit the public only under the usually unrealistic assumption that cost reductions are passed on to them. Part of the FDIC's action under this program was to fold its Division of Consumer and Compliance Affairs, which had been independent since 1991, into the Division of Supervision. That one policy shift alone has significant CRA ramifications, because the former division, under Steve Cross, who has since left the FDIC, was the informal CRA regulatory nerve center. To the extent that the division is reduced in importance or, worse yet, consolidated into another suggests a non-CRA and more generally nonconsumer mindset at the FDIC.

The OTS budget cuts received much more interest because that agency has long been rumored to be a candidate for consolidation into the OCC, also a part of the Department of the Treasury. The OTS has lost money every year since 1998, is reeling from bad public relations after a few spectacular thrift failures, and expects losses in 2002 of nearly $2 million (Blackwell and Garver 2002).

Assessment income at the OTS dropped markedly during the past decade as the number of thrifts fell by more than half. The agency responded by raising fees and examination charges. This angered many thrifts, causing some to convert to banks. The recent conversion of one of its larger members (Cleveland's Charter One Financial) to an OCC bank reportedly reduced assessment income at the OTS by $4.2 million annually and caused their projected 2002 operating deficit to swell from $2 million to $5 million (Garver 2002).

The vulnerability of the OTS to the loss of another large thrift calls into question its continued viability as an effective regulator in the public interest. According to March 31, 2002 asset totals from the FDIC, there are three other thrifts larger than the $37.7 billion Charter One, with the $275.2 billion and growing Washington Mutual (Wamu) being the largest by far. With total thrift industry assets of $998 billion as of that same time according to the OTS, Wamu represents a whopping 28 percent of the entire industry. It is also the nation's third largest subprime mortgage lender.

Considering that the OTS probably could not survive as an independent agency if Wamu defected, how can it be an effective regulator of that giant thrift? Will the OTS really tell it what it thinks or be more concerned about upsetting Wamu and losing its "business"? Who wants to be the OTS examiner willing to tell it "no," especially in a sensitive area such as subprime lending? It seems appropriate to ask the question: Does the OTS regulate Wamu or does Wamu regulate the OTS? Such important public policy matters must be addressed, especially as Wamu keeps growing and the OTS keeps shrinking.

The OTS unveiled a restructuring plan in April 2002 to enable it to remain an independent agency. This involved a 20 percent staff cut to about 930 employees, with compliance examiners being reduced at more than three times the rate of those for safety and soundness. Significantly, the OTS eliminated separate compliance exams and examiners. In a stunning change in bank regulatory policy, the OTS called for thrifts to conduct a self-evaluation of their compliance before examiners arrived for the new consolidated exam, an approach it claimed would "place emphasis on institutions, not the regulator, to ensure compliance with all existing laws, including consumer protection statutes" (Heller 2002). The latter statutes include the CRA and about 25 other laws such as Truth-in-Lending, Truth-in-Savings, and many more.

This OTS statement, in addition to being what Congressman John LaFalce of New York called a "complete abrogation of the mandate your agency has been given by Congress" (Heller 2002), is nothing less than a breakdown of the CRA Triangle. This is also the best justification yet for why this desperately struggling agency, like the troubled thrifts it used to regulate, should be merged into the OCC or perhaps made a division within it. Mutual institutions and other specialized thrift lenders regulated by the OTS would continue to coexist with their stock-based counterparts.

The only thing worse than a compliance self-evaluation is no compliance law at all, which was the case prior to 1977 for CRA. Moreover, past experience has shown that CRA is best monitored and enforced with specialized compliance examiners and separate exams. Specialized CRA examiners first existed at the Fed in 1977 with the passage of that law. The other agencies, which operate under tighter budgetary restrictions than the money-creating Fed, did not follow until and after 1989, CRA's watershed year. The OTS developed its specialized compliance program in 1989. It was followed by the FDIC in 1991 and the OCC a few years later.

A comparison of CRA ratings for the 15-month period both before and after the creation of the OTS specialized compliance function shows dramatic results (Thomas 1993). There was a roughly sixfold increase in the percentage of below-average ratings, from 3.7 percent to 22.5 percent. The comparable proportion of above-average ratings decreased from 11.3 percent to 9.4 percent.

The differences were even more dramatic following the initial "transition" quarter under the new system: below- and above-average ratings for the 12 months after the change were 25.0 percent and 2.5 percent, respectively. This would mean a nearly sevenfold increase in below-average and nearly fivefold decrease in above-average ratings. This evidence, although for only one of the four federal regulators, suggests that the use of specialized compliance examination results in much stricter enforcement of CRA, defined in terms of a greater percentage of below-average and a lesser percentage of above-average ratings.

Based on this experience, the recent shift by both the FDIC and OTS away from specialized compliance examiners and exams may result in the opposite effect, namely, less strict enforcement of CRA. This is most likely to be the case with the OTS, with its planned self-evaluation format, where the emphasis will be on the institutions, not the regulators, to ensure regulatory compliance. Less-strict enforcement of CRA is not good public policy, especially in a grade-inflationary environment.

The FDIC and especially the OTS compliance consolidations suggest that it may be time to revisit the proposal (see Tables 2 and 3) to consolidate the compliance function of all four regulators into an FFIEC-style "super-regulator" for compliance. This would be similar to past proposals to create an independent super-regulator for safety and soundness purposes (Thomas 1994).

Other Key Reform Issues

Community groups are correct in asking for a fix to the rampant grade inflation problem, more credit for originated as opposed to purchased loans, a fifth High Satisfactory overall rating, repeal of the longer 1999 Gramm-Leach-Bliley Act (GLB) exam cycles, and an expansion of CRA, at least to credit unions. This latter recommendation is important, as the proportion of home purchase loans made by CRA-covered institutions continues to fall, with less than 30 percent of home purchase mortgages being subject to intensive CRA review ("25th" 2002).

Many of the CRA reforms championed by community groups are found in the proposed CRA Modernization Act of 2001. The NCRC takes credit for being the "lead organization" for the introduction of this proposed legislation (NCRC 2002). Its congressional sponsors are essentially the same members who signed a boilerplate "NCRC Sample Letter on the CRA ANPR," which was reprinted on October 16, 2001 on congressional letterhead and submitted to regulators as a CRA reform comment. This legislation would extend CRA to insurance companies, securities firms, and holding company affiliates. It also contains CRA rating penalties for institutions engaging in predatory lending, a fifth overall High Satisfactory rating, a repeal of the longer CRA exam cycles of GLB, and additional data collection and reporting requirements. Among its most controversial portions are an effort to make CRA a race-based law and a repeal of the GLB "sunshine" requirements regarding the disclosure of CRA agreements between banks and community groups. For these and other reasons, there is little chance that this proposal will be enacted into law.

Conclusion

CRA's success has been in its simplicity, something somewhat forgotten during the 1993–95 reform process with the creation of separate investment and service tests on top of the lending ones. Good public policy in CRA must be focused on LMI lending, the purpose of the 1977 law. As was the case with the last reform process, bank regulators, Congress, and the Bush Administration will, ideally, see to it that the ongoing dynamic tension between industry and community interests results in balanced reforms.

It is more important than ever that this public policy deliberation be conducted with a full view of the potential conflicts and constraints of each of the corners of the CRA Triangle as described above. Many of these issues did not exist during the last reform process, but they are most relevant today. It is respectfully suggested that the reform recommendations in Table 6, especially the streamlined large retail bank exam, are optimal in the sense that they represent an objective, balanced perspective of both community and industry interests with full recognition of all relevant conflicts and constraints.

Table 2 Comparison of Old and "New" CRA Proposals and Final 1995 Regulations

"Old" CRA Regulations	December 1993 Proposal
One test with 12 assessment factors applies to all institutions	Separate tests for small and large retail institutions
No streamlined assessment method for smaller institutions	Independent banks and thrifts with total assets of under $250 million or members of a holding company with total banking and thrifts assets of less than $250 million could be evaluated under streamlined procedures, if eligible. Under the lending test, a 60 percent loan-to-deposit ratio and a good loan mix, among other things, would be presumed Satisfactory.
No separate test for large retail institutions	Three assessment tests—lending, investment, and service—for all large retail institutions
No separate test for wholesale and limited-purpose institutions	Wholesale and limited-purpose institutions evaluated primarily under the investment test
No alternative assessment methods	Institutions could elect evaluation based on a preapproved two-year strategic plan developed by the bank or thrift with input from the local community
Determination of overall rating is subjective without any weighting of assessment factors	For retail institutions, the rating under the lending test would form the basis for the composite rating; the rating could then be increased or decreased based on extraordinarily weak or strong performance under the service and investment tests
Institutions assessed on their method of delineating the "local community." The "delineated community" is defined as the contiguous area surrounding each office or group of offices.	Geographic area around each office or group of offices where an institution makes the bulk of its loans would define its "service area." Service area must be broad enough to include low- and moderate-income (LMI) areas. Institutions providing services in multiple metropolitan statistical areas (MSAs) or across state lines would have separate service areas for each market.

Source: The CRA Handbook (McGraw-Hill, 1998).

September 1994 Proposal	May 1995 Final "New" CRA Regulations
Separate tests for small and large retail as well as wholesale and limited-purpose institutions	Separate tests for small and large retail as well as wholesale and limited-purpose institutions
The streamlined assessment method would be used for evaluating small institutions, unless the bank or thrift requests an alternative assessment method or is operating under an approved strategic plan. The loan mix and 60 percent loan-to-deposit presumptive ratio for a Satisfactory rating would be eliminated.	Independent banks and thrifts with total assets of under $250 million or members of a holding company with total banking and thrift assets of less than $1 billion would be evaluated under streamlined procedures, if eligible. The streamlined method would be used for evaluating small institutions, unless they request an alternative assessment method or are operating under an approved strategic plan.
Three assessment tests—lending, investment, and service—for all large retail institutions	Three assessment tests—lending, investment, and service—for all large retail institutions
Wholesale and limited-purpose institutions evaluated primarily under a new community development test	Wholesale and limited-purpose institutions evaluated primarily under a new community development test
Strategic plan option is revised to provide greater clarification of plan development process, provisions for community input, approval standards, and goal specifications. Maximum plan term is lengthened to five years, with annual interim. Measurable goals required. Plan amendment procedures are included.	Strategic plan option is retained. Institutions required to describe informal efforts to seek public suggestions. Institutions may elect alternative assessment method if it fails to meet substantially its planned goals for a Satisfactory rating.
A retail institution must be rated Satisfactory or better under the lending test to receive an overall rating of satisfactory. The effect of the service and investment test on the overall rating would no longer be limited to situations where service or investment performance is extraordinarily weak or strong.	A retail institution must be rated Low Satisfactory or better under the lending test to receive an overall rating of Satisfactory. The effect of the service and investment tests on the overall rating is not limited to situations where service or investment performance is extraordinarily weak or strong.
The "service area" of a retail institution would have to include the local areas around its deposit taking facilities in which it has originated or has outstanding a significant number of loans and all other areas equidistant from those facilities. Service areas must include entire census tracts and block numbering areas. The LMI requirement is removed. Institutions not assessed on method of service area delineation.	The "assessment area" of a retail institution would have to include the local areas around its deposit taking facilities in which it has originated or purchased a substantial portion of its loans. Assessment areas must consist generally of one or more MSAs or contiguous political subdivisions and must include full census tracts and block numbering areas. Institutions not assessed on method of assessment area delineation. (Continued)

Table 2 Comparison of Old and "New" CRA Proposals (Continued)

"Old" CRA Regulations	**December 1993 Proposal**
No market share provisions	A "market share screen" under the lending test would establish a rebuttable presumption that an institution's CRA performance was at a certain level based on market share of loans in middle-income and upper-income areas compared to market share of loans in lower-income and moderate-income areas.
Institutions are required to prepare lengthy CRA statements by an actively participating board and prepare documentation of meetings, marketing, outreach, and credit needs ascertainment efforts	Emphasis is placed on performance over process—institutions would no longer be required to devote resources to "documenting the files"
Enforcement tools limited to denial or conditioning of corporate applications filed by institutions with poor CRA performance or substantial unresolved CRA protests	In addition to taking CRA performance into account when acting on applications, regulators would enforce CRA compliance in the same manner as any other regulation and could impose formal enforcement actions for Substantial Noncompliance ratings (which would be automatic upon the third consecutive Needs to Improve or lower rating)
No publication of scheduled CRA exams	Bank regulators required to publish quarterly scheduled CRA exams
No race or gender data collected for consumer, small business, or small farm loans	No race or gender data collected for consumer, small business, or small farm loans
No data collected and reported on the geographic distribution of loans or the race, ethnicity and gender of borrowers, other than data on mortgages reported pursuant to the Home Mortgage Disclosure Act (HMDA)	Large banks and thrifts would be required to collect and report data on the geographic distribution of housing, consumer, small business, and farm loans, and on loan applications, denials, originations, purchases, sales, and retirements. They would also report data on the size of the businesses to which loans were made. These new reporting requirements would be in addition to existing HMDA reporting requirements and Call Report requirements for small business and farm loans.

September 1994 Proposal	May 1995 Final "New"CRA Regulations
Explicit market share language has been eliminated from the regulation. Market share analysis is one of a broad variety of comparisons that examiners would use where appropriate in evaluating performance under the lending test.	Explicit market share language has been eliminated from the regulation. Market share analysis is one of a broad variety of comparisons that examiners would use where appropriate in evaluating performance under the lending test.
Emphasis would remain on performance over process	Emphasis would remain on performance over process
In addition to taking CRA performance into account when acting on applications, regulators would enforce CRA compliance in the same manner as any other regulation and could impose formal enforcement actions for Substantial Noncompliance ratings (which would be automatic upon the third consecutive Needs to Improve or lower rating)	December 1994 Department of Justice opinion prevents imposition of formal enforcement actions. Consequently, enforcement tools limited to denial or conditioning of corporate applications filed by institutions with poor CRA performance. Automatic downgrading of third Needs to Improve rating eliminated.
Quarterly published lists of scheduled CRA exams retained	Quarterly published lists of scheduled CRA exams retained
Large banks and thrifts would have to collect race, ethnicity and gender data on small business and small farm loans	No race or gender data collected for consumer, small business, or small farm loans
Agencies would base their analysis of mortgages lending on the data already reported under HMDA. However, large institutions reporting under HMDA, as well as small institutions who elect evaluation under the lending, investment,and service tests, would also be required to report data on home mortgage loans made outside of MSAs.Large banks and thrifts would collect and report certain data on the geographic distribution of and the race, ethnicity, and gender of small business and small farm borrowers who have loans that are currently aggregated on bank Call Reports. Some data would be reported by loan size and would include an indication of whether the business or farm had gross annual revenues of more or less than $1 million. Aggregate data on small business and small farm loans and community development loans would be included in an institution's Public file. The agencies would not make any aggregate data available to the public.	Agencies would base their analysis of mortgage lending on the data already reported under HMDA. However, large institutions reporting under HMDA,as well as small institutions who elect evaluation under the lending, investment and service tests, would also be required to report data on home mortgage loans made outside of MSAs. Large banks and thrifts (and small ones that elect such evaluation) must collect and report certain data on the geographic distribution of small business and small farm borrowers. These data must be reported by loan size and include an indication of whether the business or farm had gross annual revenues of more or less than $1 million. The agencies rather than institutions will prepare annual and business loan data by geography for each reporting institution and aggregate statements for each MSA and the non-MSA portion of each state. Although there are no reporting requirements for consumer lending, an institution with a substantial majority of its business of this type will have such lending evaluated under the lending test.

Table 3 Comparison of "Old"and "New"CRA Assessment Factors and Performance Standards

"Old"CRA	"New"CRA	
	Small Bank Test	**Large Retail Bank Test**
	Lending Test	
Assessment Factor	**Lending Performance Assessment Criteria**	**Lending Test**
I,J:Origination of loans and participation in government loan programs	Loan-to-deposit ratio	Lending activity levels responsive to AA credit needs
E:Geographic distribution of loans	Percentage loans in AA	Percentage loans in AA
	Borrower distribution by income and business/farm size in AA	Borrower distribution by income and business/farm size in AA
	Geographic distribution of loans in AA	Geographic distribution of loans in AA
		Lending to highly economically disadvantaged geographies and low income people and very small businesses in AA
		Use of innovative and/or flexible lending practices
H: Participation and investments in CD projects		CD lending activities
	Investment Test	
Assessment Factor	**Optional Investment Test to Upgrade "Satisfactory" Rating**	**Investment Test**
H: Participation and investments in CD projects	Investment record enhances credit availability in AA	Amount of qualified CD investments and grants
		Use of innovative and/or complex qualified investments to support CD
		Responsiveness to credit and community economic development needs

Source:The CRA Handbook (McGraw-Hill,1998).

"New" CRA	
Wholesale and Limited-Purpose Banks Community Development Test	**Strategic Plan Test**
Lending Test	
CD Loans	**Lending Goals**
Responsiveness to credit and community economic development needs in AA	Measurable goals for helping to meet AA credit needs, particularly those of LMI geographies and individuals. Goals must be responsive to AA characteristics; public comments; and the bank's capacity and constraints, product offerings, and business strategy.
Level of CD lending*	
Use of innovative or complex CD loans*	
Investment Test	
CD Investments	**Investment Goals**
Level of qualified investments*	Preferably measurable investment goals that are responsive to AA characteristics and credit needs, particularly those of LMI geographies and individuals; public comments; and the bank's capacity and constraints, product offerings, and business strategy.
Use of innovative or complex qualified investments*	
Responsiveness to credit and community economic development needs in AA; agencies would not make any aggregate data available to the public	(Continued)

*Part of one performance standard

Table 3 Comparison of "Old" and "New" CRA Assessment Factors and Performance Standards (Continued)

"Old" CRA	"New" CRA	
	Small Bank Test	**Large Retail Bank Test** **Service Test**
Service Test		
Assessment Factor	**Optional Service Test to Upgrade "Satisfactory" Rating**	**Service Test**
G: Record of providing services at offices	Record of providing delivery systems and other services enhances credit availability in AA	Accessibility of delivery systems to all portions of the AA
H: Participation and investments in CD projects		Record of opening and closing offices
		Reasonableness of business hours and services in AA
		Level of CD services
Miscellaneous Tests		
D: Practices intended to discourage loan applications	Practices reviewed but not rated	Practices reviewed but not rated
F: Prohibited discrimination or other illegal practices	Practices reviewed but not rated	Practices reviewed but not rated
L: Other factors regarding credit needs	Record of taking action on substantiated complaints	Response to complaints reviewed but not rated
K: Institution's ability to meet community credit need	Considered in "Performance Context"	Considered in "Performance Context"
A: Ascertain community credit needs	Considered in "Performance Context"	Considered in "Performance Context"
B: Marketing and special programs to enhance credit awareness	Considered in "Performance Context"	Considered in "Performance Context"
C: Board of directors' participation	Assessment Factor not reviewed or rated	Assessment Factor not reviewed or rated
Reasonableness of delineated community evaluated as "13th" assessment factor	Reasonableness of delineated assessment area not evaluated as separate performance criterion but must meet stated requirements	Reasonableness of delineated assessment area not evaluated as separate performance criterion but must meet stated requirements

"New" CRA	
Wholesale and Limited-Purpose Banks Community Development Test	**Strategic Plan Test**
Service Test	
CD Services	**Service Goals**
	Preferably measurable service goals that are responsive to AA characteristics and credit needs, particularly those of LMI geographies and individuals; public comments; and the bank's capacity and constraints, product offerings and business strategy.
Level of CD services*	
Use of innovative or complex CD services*	
Miscellaneous Tests	
Practices reviewed but not rated	Practices reviewed but not rated
Practices reviewed but not rated	Practices reviewed but not rated
Response to complaints reviewed but not rated	Response to complaints reviewed but not rated
Considered in "Performance Context"	Considered in "Performance Context"
Considered in "Performance Context"	Considered in "Performance Context"
Considered in "Performance Context"	Considered in "Performance Context"
Assessment Factor not reviewed or rated	Assessment Factor not reviewed or rated
Reasonableness of delineated assessment area not evaluated as separate performance criterion but must meet stated requirements	Reasonableness of delineated assessment area not evaluated as separate performance criterion but must meet stated requirements

* Part of one performance standard

Table 4 Selected Bank and Thrift Industry Comments on 2002 CRA Reforms

Source of Comment	General Comments	Large Retail Institutions: The Lending, Service, and Investment Tests — Lending Test
American Bankers Association (all banks)	Large bank exam has increased compliance burden; do not require banks to demonstrate that some CRA activities have been "innovative" or "complex"; annual review of CRA ratings for more consistency among agencies; PE should clearly show date exam began and ended as well as review period	Treat originations and purchases identically; keep predatory lending issues as part of fair lending exam rather than CRA exam
America's Community Banks (mainly thrifts)	More examiner training and guidance; need incentives to achieve higher ratings	Grant same weight to purchased loans as originated ones
California Bankers Association	Inconsistency and uncertainty of CRA exams and ratings across agencies and elsewhere require examiner training and better pre-exam communications; innovative and complex CRA activities should not be required for Outstanding rating	Large bank exam should be primarily based on qualifying loans with the option of investment or service activity; maintain credit for originations as well as purchases; do not include predatory lending concerns in PE as they should be covered in fair lending exam.
California Federal Bank	Incentives for Outstanding rating such as streamlined CRA exam or application review; overemphasis on quantitative measures causes very good but smaller projects to be overlooked	Less quantitative emphasis, especially in areas with limited CRA product; better developed benchmarks in evaluations; review lending for harmful or abusive practices in context of fair lending exam; letters of credit should count equally as loans; equal treatment of purchased and originated loans

Source: Individual organizations.

Large Retail Institutions: The Lending, Service, and Investment Tests

Investment Test	Service Test	Community Development (CD) Activities
Eliminate and make investments substitutable for loans; return focus of CRA to credit rather than CD and investments; investment test is #1 CRA problem for large banks; qualified investments are limited, expensive with "CRA premium," and create documentation burden; investment test not authorized by CRA; no statutory authority for this test	Depends too heavily on branches; broader definition of service to include LMI financial education and nontraditional banking; no statutory authority for this test	No need for separate test; expand definition of CD activities to include all revitalization and stabilization activities, regardless of location
Must be eliminated, revised, or its relative importance reduced or even made optional for "extra credit"; ignores type of investment by giving more credit to easy investment vs. partnering with community group		
Remove as required test; expand scope of qualified investments		
Ineffective and often problematic; combine with lending test or replace with CD test; greater recognition of credit for written-off equity investments	Largely been effective but needs updating for alternative delivery channels; expand CD services to include nonfinancial activities	More inclusive definition of CD; expand double-counting of affordable multifamily lending under both HMDA and CD

(Continued)

Table 4 Selected Bank and Thrift Industry Comments (Continued)

Source of Comment	**General Comments**	**Large Retail Institutions: The Lending, Service, and Investment Tests**
		Lending Test
Consumers Bankers Association (mainly large banks)	No major rewrite; more incentives if get Outstanding rating; greater agency consistency; greater opportunity to shift among investment, lending, and service tests to meet local needs	Equal treatment of purchases and originations; consistent consideration of letters of credit
The Financial Services Roundtable (100 largest financial companies)	Member companies split, but most see no need for major reform but only "tweaking"; more flexibility during exams and less emphasis on requiring "innovative" and "complex" activities	No change to current treatment of purchases vs. originations; consideration of letters of credit; consideration of "harmful" and "abusive" lending practices too subjective and would be very difficult and counterproductive
FleetBoston Financial	More detailed examiner guidance on qualitative factors	Keep at 50 percent; include letters of credit for CD loans
Independent Community Bankers of America (mainly small banks)	Better exam procedures and training; public file only available at main office; address industry perception that Outstanding rating is out of reach for small banks	Prefer identical treatment of purchased and originated loans, but possible discounting of purchased loans far outside AA
Massachusetts Bankers Association	Lending and service tests are paramount; investment test should be secondary, optional, and sometimes unnecessary; only use innovative and complex criteria to improve rating	
Utah Bankers Association		Make more flexible and less reliant on quantitative measures; do not require CD investments and services to get a Satisfactory rating

Large Retail Institutions: The Lending, Service, and Investment Tests

Investment Test	**Service Test**	**Community Development (CD) Activities**
Limited number of investments, and heavy competition for them results in low returns; many investments essentially become grants; unrealistic expectations and ultimately too costly	More weight to alternative delivery channels besides branches	Credit for more activities, even non–LMI related; credit for non–AA CD activities if meet AA needs
Several members favor elimination of test or at least subsuming in Lending Test so investments substitutable for loans; some members would like all three tests counted equally; recommends choice between existing system and a modified CD test that allows more flexibility	Credit for ATMs used by LMI people; more consideration for flexible and innovative deposit accounts	
Eliminate; limited number of investments with pricing problems; considerable overlap with CD loans; evaluate as part of new CD test	Reduce to 20 percent	New test at 30 percent
Less emphasis on investments and more on loans; one recommended solution is elimination of investment test and making it optional for extra credit; credit for investments outside of AA; expand qualified investments to include municipal development bonds	Consider alternative delivery systems such as the internet and special purpose deposit accounts; credit for CD services even if not financially related	Better definition of CD activities; credit for any economic development activity, even if not LMI related
Eliminate as required benchmark and make use and weighting of it at discretion of bank		Restrict CD concept to investments rather than loans or services
Make optional and count investments for extra credit or as a substitute for loans; expand scope of qualified investments	Count services for extra credit or as a substitute for loans	Broaden scope of CD investments and services to benefit entire community, not just LMI areas

(Continued)

Table 4 Selected Bank and Thrift Industry Comments (Continued)

Source of Comment	Small Institution: The Streamlined Small Institution Evaluation	Limited Purpose (LP) and Wholesale Institutions: The Community Development Test
American Bankers Association (all banks)	Eliminate optional investment test; increase independent small bank size minimum to $1 billion; remove holding company definition	Greater flexibility in definition of special purpose banks so more banks can use this test; consider this flexible test for retail banks; more liberal consideration of qualified investments;credit for nonlocal CD activities
America's Community Banks (mainly thrifts)	Increase in size definition of small independents to $1 billion and holding companies to $5 billion in assets is most important reform proposal	
California Bankers Association	Raise small bank cutoff to $1 billion in assets	
California Federal Bank		Should be option for large retail institutions
Consumers Bankers Association (mainly large banks)		Greater flexibility in definition of special purpose banks
The Financial Services Roundtable (100 largest financial companies)		Broader definitions to include those with alternative, non–branch delivery systems
FleetBoston Financial		
Independent Community Bankers of America (mainly small banks)	Top priority is increase in size of small independent banks to at least $1 billion in assets and preferably $2 billion; prefer eliminating holding company minimum, but otherwise $5 billion minimum	

Strategic Plan	Performance Context (PC)	Assessment Area (AA)
Retain this option for flexibility; only community groups within AA should have standing to comment on plan;more consistent treatment among regions	Examiners must provide banks with more information on PC, including peer comparisons and possibly mandatory pre-exam consultations	Maintain current approach; flexibility to designate larger AAs to include states and regions rather than just MSAs
Maintain it as flexible alternative for nontraditional banks like internet ones; promote more at regional or local level	Competition must be more realistically considered; examiners must provide specific quantifiable goals	Separate AA designation for internet banks; credit for loans and investments outside AA as long as AA needs met
	Examiner must obtain bank's concurrence on elements of PC as early as possible	Examiners do not question bank's designation of AA
Current process arduous and related risks too great	Has not been effectively used, especially when excess competition for limited CRA product; must be more consistent among agencies; components of PC should be shared with bank to create a dialog	Current approach is sufficient and reasonable
	More and better use	Credit for lending outside AA if meet needs within; delineate AAs around deposit facilities only
		Most members feel no need to change, but some want more flexibility if don't use branches
	Must be given more consideration	Credit for all activities outside of AA as long as adequately met needs within AA
	More fully shared with banks before and during exam; especially important in loan-to-deposit ratio evaluation	Maintain current approach with greater latitude to designate LMI areas

(Continued)

Table 4 Selected Bank and Thrift Industry Comments (Continued)

Source of Comment	Small Institution:The Streamlined Small Institution Evaluation	Limited Purpose (LP) and Wholesale Institutions:The Community Development Test
Massachusetts Bankers Association	Extend small bank designation to assets of $1 billion or less	
Utah Bankers Association		Make easier to qualify as LP institution by eliminating requirement of offering credit cards or car loans exclusively

Strategic Plan	Performance Context (PC)	Assessment Area (AA)
		AA concept is neither useful nor practical and increasingly irrelevant;CRA credit for LMI loans anywhere in state, regardless of AA;flexibility to designate regional or statewide AAs
Make easier to apply for and modify		Continue definition based on area around offices; exclude areas where bank has no presence

(Continued)

Table 4 Selected Bank and Thrift Industry Comments (Continued)

Source of Comment	Activities of Affiliates	Data Collection and Maintenance of Public Files
American Bankers Association (all banks)	Maintain current approach for flexibility	End current data collection requirements or apply only to banks with 250 or more reportable loans;strongly opposes any more data collection or reporting;current small business and farm lending data collection and reporting inconsistent with CRA
America's Community Banks (mainly thrifts)	Maintain present optional approach	Data collecting and maintaining public files are a burden; not convinced collected data are useful
California Bankers Association		Streamlined data requirements for banks making a small number of covered loans
California Federal Bank	Maintain current approach as being consistent with statute	No changes to data collection; systems in place and function well;public file only at main office since minimal requests (five or less per year) and long PE (450 pages)
Consumers Bankers Association (mainly large banks)	Retain current approach	Agencies badly underestimate compliance cost and time, but they are coming down with time; no additional requirements needed
The Financial Services Roundtable (100 largest financial companies)	Maintain current approach for flexibility	Current requirements unduly burdensome and data of minimal use; eliminate current data collection requirements; strongly oppose any new requirements; make public file available at just one central location
FleetBoston Financial	Maintain flexibility of current approach	Current data collection and reporting is huge burden and expensive undertaking but effective;no additional requirements needed

Source of Comment	Activities of Affiliates	Data Collection and Maintenance of Public Files
Independent Community Bankers of America (mainly small banks)		Eliminate since costs cannot justify benefits
Massachusetts Bankers Association		Strongly oppose any new requirements; existing requirements, except for HMDA,should be optional; existing CRA data of little value
Utah Bankers Association		Discontinue CRA reporting of small business loans; reports of little value and extremely costly

Table 5 Selected Community Group Comments on 2002 CRA Reforms

Source of Comment	General Comments	Large Retail Institutions: The Lending, Service, and Investment Tests Lending Test
ACORN	Upgrade ratings standards to reduce grade inflation	Consider quality as well as quantity of loans; penalize lenders with originated or purchased loans with abusive or predatory terms; evaluate pricing to make sure prime borrowers do not have subprime rates or terms; count purchases much less than originations
California Reinvestment Committee	Fifth High Satisfactory overall rating; Low Satisfactory banks must submit public improvement plan; use qualitative factors only to improve Satisfactory rating; revise CRA to focus on race as well as income	Credit for multifamily lending in low income areas only if to LMI tenants;no loan should count more than once; penalize any predatory or payday lending;little to no credit for subprime lending
Center for Community Change	Too much emphasis on performance of large banks in urban centers vs. rural areas;increased use of community group contacts during exams	Credit to move subprime borrowers to prime market; deny CRA credit for any predatory loans
Community Reinvestment Association of NC	Conduct CRA, fair lending, and safety and soundness exams concurrently; incentives to increase prime lending; don't provide excess credit for "innovative" programs; fifth overall High Satisfactory rating; Low Satisfactory or lower rating requires improvement plan with public comment period;apply Gramm-Leach-Bliley Act restriction that all banks with failing ratings cannot expand into the securities or insurance business to both acquiring and acquired banks;public hearings on any proposed CRA reforms	Evaluate subprime lending; consider minorities in exam like LMI borrowers;purchased loans not counted as much as originated ones;no credit for payday lending

Source: Individual community groups.

Large Retail Institutions: The Lending, Service, and Investment Tests

Investment Test	**Service Test**	**Community Development (CD) Activities**
Maintain; more weight to grants; no credit for MBS with underlying predatory features	Maintain; quantify use of low-cost banking services such as lifeline banking accounts; banks partnering with check cashers or payday lenders receive below satisfactory rating on Service Test	Opposed to separate CD test
Maintain test; loan purchases get credit only under Investment Test; most credit for contributions and less credit for MBS	Consider fees in service test; better description of CD services in PE; banks must provide lifeline banking products	Include race as factor in defining CD; no credit for CD services outside of AA
Maintain	Maintain but increase quantitative analysis and rigor	Do not develop separate CD test; limit CRA credit to LMI activities
	Disclosure of checking and savings accounts with fee information	

(Continued)

Table 5 Selected Community Group Comments (Continued)

Source of Comment	General Comments	Large Retail Institutions: The Lending, Service, and Investment Tests — Lending Test
Delaware Community Reinvestment Action Council, Inc.	Conduct CRA, fair lending, and safety and soundness exams concurrently; emphasis on quantitative criteria;"innovative" programs do not compensate for otherwise bad performance; fifth High Satisfactory overall rating; Low Satisfactory banks must submit public improvement plan; GLB expansion restriction due to poor CRA ratings applies to both banks in a deal;public hearings to discuss CRA reform	Penalize lenders for making predatory loans; subprime lenders must show that no creditworthy borrower was offered subprime loan;purchased loans not given same weight as originated ones
The Greenlining Institute	Include insurance company activities related to covered banking activities; add High Satisfactory overall rating; give out more Needs to Improve ratings; reward leadership efforts by banks; public hearings for all mergers of $1 billion or more in assets if either party has Below Average component test rating	
National Community Reinvestment Coalition	Add fifth overall rating of High Satisfactory; overall ratings of Low Satisfactory or less require public improvement plan with comment period;strengthen CRA enforcement; additional prompt disclosure of CRA appeals; emphasize quantitative approach; conduct CRA, fair lending, and safety and soundness exams concurrently	Subprime lending does not count as much as prime lending;severe penalties for any predatory lending; explicit consideration of minorities just like LMI people and areas
National Congress for Community Economic Development	Use qualitative factors only to upgrade bank if High Satisfactory rating;Outstanding rating denied if bank rated Needs to Improve on any component test; Satisfactory rating only if no Substantial Noncompliance rating in any component test	Qualitative analysis of lending for costs and abusive terms; consider number of loans besides amount; originations given more weight than purchases;include neighborhood race data in geographic distribution; penalty for predatory lending but bonus for “referring up” subprime customers

Large Retail Institutions: The Lending, Service, and Investment Tests

Investment Test	**Service Test**	**Community Development (CD) Activities**
Maintain as there is a need for equity investments in LMI areas	Data on number of checking and savings accounts by income and minority status and location; include fees and cost of deposit services; CRA credit for affordable services to LMI areas	
Bonus credits for key grants		
Needed since LMI areas have shortage of equity investments for small businesses; quantitative benchmark such as ratio of CD investments to assets; also use ratio of nonprofit grants to assets; more credit to investments with better LMI impact	Must be more rigorous due to grade inflation; require new data on savings and checking accounts; require branch distribution data in PEs; include data on cost of services; no credit for payday lending; only allow credit for alternative delivery systems or CD services if impact LMI borrowers	Banks have discretion to consider CD loans as qualified investments without securitizing them; no expansion of credit for CD activities outside of broader regional or statewide area including AA
Maintain; distinguish between low- and high-risk investments; measure bank grants relative to bank earnings; review investments for underlying predatory features	Maintain; quantify use of low-cost banking services such as lifeline banking accounts; banks partnering with check cashers or payday lenders receive Below Satisfactory rating on Service Test; require more quantitative measures of alternative services	Do not make separate test; count CD credit under Investment or Lending Tests; narrow current CD definition to focus on LMI and race

(Continued)

Table 5 Selected Community Group Comments (Continued)

Source of Comment	**General Comments**	**Large Retail Institutions: The Lending, Service,and Investment Tests**
		Lending Test
Neighborhood Reinvestment Corporation	Add fifth overall rating of High Satisfactory	Focus more on quality rather than quantity of lending, especially as related to predatory loans; bonus credit for low-cost alternatives to payday lending
Woodstock Institute	Tougher overall rating requirements based on component test ratings	More weight for originations vs. purchases;include race as well as income criteria; evaluate quality as well as quantity of lending; examine subprime lending for predatory features, which result in low rating; evaluate all home-secured loans not just mortgage loans

Large Retail Institutions: The Lending, Service, and Investment Tests

Investment Test	Service Test	Community Development (CD) Activities
Increase weighting in certain cases; encourage substantive grants or investments in nonprofits	Evaluate whether retail banking services easily accessible by LMI people and areas	
Minimum Low Satisfactory rating on this test for overall passing rating; distinguish investments based on risk and return; review MBS for underlying predatory features	Minimum Low Satisfactory rating on this test for overall passing rating; consider distribution of bank accounts by income, race, and geography; Outstanding rating on this test requires lifeline banking, multiple delivery systems, or account alternatives as well as innovative and complex services; internet or trust banks can provide CD services and investments	More restrictive CD definition

(Continued)

Table 5 Selected Community Group Comments (Continued)

Source of Comment	Small Institution: The Streamlined Small Institution Evaluation	Limited Purpose and Wholesale Institutions: The Community Development Test
ACORN	Maintain existing size requirements	
California Reinvestment Committee	Maintain existing size requirements; require Service Test for all small banks; require CD lending and investments for Outstanding rating for banks in $100–250 million range	Do not expand definition of banks here; do not apply to other banks
Center for Community Change	Maintain existing size requirements; more detailed performance data should be in PE; tougher loan to deposit standards in rural areas	Too much discretion in designations; clearer standards required
Community Reinvestment Association of NC	Maintain existing size requirements; more detailed data requirements and analysis; require Investment and Service Tests for small banks	
Delaware Community Reinvestment Action Council, Inc.		
The Greenlining Institute		
National Community Reinvestment Coalition	Do not allow any more banks to qualify for this test; make optional Investment and Service Tests mandatory; propose minimum 75 percent loan-to-deposit ratio for satisfactory rating	Do not apply to retail banks including branchless or internet ones; tighten application standards to avoid further inappropriate qualifications

Strategic Plan	**Performance Context (PC)**	**Assessment Area (AA)**
	Contact local groups and residents to ascertain community needs	Include entire MSA;nontraditional banks define AAs based on substantial share of loans (defined as 0.5 percent)
Keep this option but increase community input and review	Examiners should make at least 20 community contacts per MSA	Banks that lend or take deposits from a significant portion of MSA market should have CRA responsibilities there; compare LMI to non-LMI aggregate market share for internet and insurance related banks
Not an effective evaluation method; rarely used or considered	Include more information on PC to make PEs more useful	Require AA to include all areas where substantial deposits or loans
		Must include communities in which a great majority of bank lending occurs
	Community outreach efforts by bank do not constitute performance assessment	Examine those communities in which a great majority of a bank's loans are made
Eliminate	Regulators should inform community groups of names of banks when seeking public input; regulators should also seek out groups besides those recommended by examined bank	Must include communities in which a great majority of bank lending occurs; expand definition to include areas where bank or affiliates have branches, ATMs, or more than 0.5 percent of loan market

(Continued)

Table 5 Selected Community Group Comments (Continued)

Source of Comment	**Small Institution:The Streamlined Small Institution Evaluation**	**Limited Purpose and Wholesale Institutions:The Community Development Test**
National Congress for Community Economic Development	Maintain existing size requirements	Current definitions inadequate as some "special purpose" banks are retail banks
Neighborhood Reinvestment Corporation	Drop loan-to-deposit ratio test	
Woodstock Institute	Maintain existing size requirements	More restrictive definitions to qualify; bank is "retail" if more than 0.5 percent market share of any product

Strategic Plan	Performance Context (PC)	Assessment Area (AA)
Not currently a viable alternative and needs reform, if not elimination		Penalize rating for banks involved with payday lenders, check cashers, or other fringe financial services, even if done outside AA; in addition to current definition, AA should also include areas where significant portion of deposits or loans emanate
Greater specificity on CD plans needed prior to merger approval		Internet and similar banks with nontraditional delivery systems should be evaluated on basis of location of deposits and other activities (e.g., define AA as all MSAs where 5 percent or more of deposits emanate)
Eliminate	Consider community group input; inform both banks and community groups of PC in advance of exam	Expand by allowing banks to base AA not just on branch locations but also on location of significant (0.5 percent or more market share) portion of deposits or loans

(Continued)

Table 5 Selected Community Group Comments (Continued)

Source of Comment	Activities of Affiliates	Data Collection and Maintenance of Public Files
ACORN	Eliminate optional treatment of affiliates	Report current data quarterly rather than annually; separate data on prime vs. subprime mortgages; require HMDA-like small business data
California Reinvestment Committee	Include activities of all subsidiaries and affiliates	Require HMDA-like small business data; report CD loan and investment data by census tract
Center for Community Change	Once a bank elects to have any affiliate's activity considered, then the activity of all other affiliates must be considered	Report small business data in HMDA format; report CD loans on census tract basis;analyze prime and subprime loans separately; report qualified investments by category and amount;improve access to non-metro mortgage lending data
Community Reinvestment Association of NC	Include activities of nondepository affiliates	Supports Fed proposal to enhance HMDA data to include APRs and fees;lift Reg B prohibition on reporting of race and gender small business data; report aggregated CD data by tract
Delaware Community Reinvestment Action Council, Inc.	CRA exams should cover all activities of nondepository affiliates	HMDA analysis of lending to minorities must be included; supports Fed's proposed addition of rate and fee data on HMDA reports; race and gender data on small business loans
The Greenlining Institute	Include activities of all subsidiaries and affiliates	CRA exams should not be colorblind—include race and ethnic data; examine and report diversity of Board,managers,and key CRA officers
National Community Reinvestment Coalition	Require all lending and banking activities of nondepository bank affiliates to be covered	Expand current requirements to include more detailed data; supports Fed proposal to enhance HMDA data to include APRs and fees;lift Reg B prohibition on reporting of race and gender small business data; report aggregated CD data by tract

Source of Comment	Activities of Affiliates	Data Collection and Maintenance of Public Files
National Congress for Community Economic Development	All lending and banking activities of nondepository affiliates must be included in CRA exams	Report small business data in HMDA format; report CD loans on census tract basis;analyze prime and subprime loans separately; report qualified investments by category and amount; improve access to non-metro mortgage lending data
Neighborhood Reinvestment Corporation	Review subprime and predatory lending of affiliates in AA, without expanding scope of CRA to other nonregulated activities	Better information on small business lending, rural lending, pricing, and fees; subprime vs. predatory loan analysis
Woodstock Institute	Include affiliates' lending;at a minimum,banks should "use all or none" approach for affiliates	Maintain existing requirement but make tougher; revise small business reporting format to be similar to HMDA; require race and gender data for small businesses;more detailed CD lending data; require detailed reporting for investments and services;more detailed reporting of existing CRA data

Table 6 Optimal CRA Reform Recommendations

General Comments

1. Return focus of CRA exam and rating to LMI lending
2. Reduction of grade inflation through joint agency examiner education
3. Expansion of CRA to at least credit unions
4. More objective, quantitative,and structured PEs, with exception of new qualitative lending criterion
5. Goal of FFIEC centralized compliance function
6. Greater consistency in exam and rating procedures among regulators and individual regions
7. Fifth Good or High Satisfactory rating
8. More detailed rating guidelines and PE disclosure of individual performance rating factors (i.e., ratings matrix)
9. Specialized compliance examiners and staff with separate exams
10. Continued focus on LMI areas and people with no consideration of race
11. Better and more timely disclosure of ratings, PEs, and appeals
12. No CRA exemptions for federally-insured depositories
13. Return to pre-GLB, more frequent, tiered exam schedule based on ratings, ranging from 6 months (worst rating) to 24-30 months (best rating)
14. Require that both the acquirer and acquiree in a bank deal have passing (i.e., Satisfactory or better) overall CRA ratings
15. Equal treatment of LMI-related outstanding loans and investments vs.new ones made during review period; no penalty for longer-term instruments
16. Time-sensitive evaluation (and pro rata weighting) of CRA performance over the entire review period, without emphasizing most recent CRA activities;limited pro rata credit for any new CRA activities within six months of exam start date with disclosure of same in PE
17. Require all community groups and coalitions involved with CRA to make sunshine filings disclosing details of all IRS Form 990 schedules showing contributor names and amounts for current and past years
18. More fact-based documentation of conclusions in PE,including mandatory use of standardized tables of performance data PEs that are as least as comprehensive as those developed by the OCC
19. All agencies should adopt all 10 recommendations to improve PEs found in the OTS Office of Inspector General Report (see OIG 2001)
20. Greater CRA data availability and ease of access (with optional e-mail notification list for specific banks or areas) from FFIEC and agency websites with announcement of upcoming exams, recent ratings, related enforcement actions, reform comments,FOIA requests and responses,appeal files,special purpose bank designation applications, and GLB sunshine reports
21. More descriptive information in all PEs about scope of exam,including starting and ending dates, review period, products reviewed,AAs covered,and even chief examiner's initials or identifying number for accountability
22. Mandatory review and potential reform of CRA five years after the complete transition to the present reforms;if the reforms due out in 2002 are fully transitioned by the end of next year, the next reform should occur in 2008

Source: K.H. Thomas,Ph.D.

Large Retail Institutions: The Lending, Service, and Investment Tests

Lending Test

1. Addition of three new ratings factors: LMI credit–related investments, LMI credit–related CD services, and LMI credit–related retail banking services
2. Expansion of innovative/flexible rating factor to more comprehensive "Qualitative Lending" one which also includes consideration of any predatory or other adverse LMI credit practices as well as "referring-up" of subprime borrowers
3. 10 rating factors evaluated under current 5 ratings (50 cells in ratings matrix) with ratings matrix disclosed in PE
4. Reduced credit for purchased loans in AA vs. originated loans to reflect additional costs and risks associated with originations; mandatory PE disclosure of amount of purchased vs. originated loans in AA
5. No credit for purchased loans if double counting or evidence of "loan swapping" among banks
6. Continue current treatment of letters of credit with notation of their volume

(Continued)

Table 6 Optimal CRA Reform Recommendations (Continued)

Large Retail Institutions: The Lending, Service, and Investment Tests

Investment Test	Service Test	CD Activities
1. Eliminate and make part of lending test 2. Only consider LMI credit–related investments with documentation of same in PE 3. Initially make this test a mandatory lending factor, with possibility of making optional as in case of small bank test 4. Credit for all LMI-related qualified investments outside AA, as long as LMI credit needs in AA being met 5. Limited credit for "over-the-counter" purchased LMI-related securities, especially MBS, bonds, and minority bank CDs with mandatory PE disclosure of same 6. Credit for all LMI credit–related qualified investments held during review period, including long-maturity ones that blanket the review period	1. Eliminate and make part of lending test 2. Only consider LMI credit–related services with documentation of same in PE 3. Initially make this test a mandatory lending factor, with possibility of making optional as in case of small bank test 4. Credit for all LMI-related CD services outside AA, as long as LMI credit needs in AA being met	1. Part of lending test 2. Maintain current CD definitions 3. Credit for all LMI-related CD activities outside of AA, as long as LMI credit needs in AA being met

Small Institution: The Streamlined Small Institution Evaluation	Limited Purpose and Wholesale Institutions: The CD Test	Strategic Plan (SP)
Double current size minimum to $500 million for independents and $2 billion for holding companies	1. More consistent definitions to insure special purpose qualification 2. Only consider activities that can be documented as LMI-related 3. Credit for LMI-related CD activities outside of AA, as long as LMI credit needs in AA being met 4. Stricter application and disclosure of performance rating factors and matrix to reduce grade inflation 5. Limited credit for banks electing single CD activity, especially purchased investments, when performance context dictates potential for additional CD activities 6. Retain innovative and complex considerations, especially for banks with single CD activities	1. Eliminate SP option 2. Banks currently under SPs will use elected backup exam method (Continued)

Table 6 Optimal CRA Reform Recommendations (Continued)

Performance Context (PC)	**Assessment Area (AA)**	**Activities of Affiliates**	**Data Collection and Maintenance of Public Files**
1. More explicit use prior to and during exam as well as in PE 2. Required PE description of how PC applied in weighting performance rating factors and the resultant impact on overall rating	1. Retain existing AA approach 2. Credit for LMI-related CD activities, especially LMI lending, outside of AA for all banks, not just nontraditional ones with alternative delivery systems, as long as local LMI credit needs being met 3. PC analysis of nontraditional banks with alternative delivery systems and very small portion of loans in AA will result in lower weighting of AA loan percentage rating factor relative to other performance factors, especially nonlocal LMI lending	Mandatory rather than optional CRA treatment of affiliates	1. Continue all existing data collection and reporting requirements 2. Maintain current public file requirement 3. Do not consider or require any race data under CRA

Notes

1. This brief is based largely on a Levy Economics Institute Working Paper (Thomas 2002a).

2. An extensive literature exists on CRA:see, for example, Haag (2000) and Litan, Retsinas, et al. (2000).

3. LMI is defined as an income of 80 percent or less of the median,that is, $40,000 or less for U.S. families, according to the 2000 Census. This includes, by definition,about 40 percent of American families.

4. It is interesting to note that the thrift and two of the three bank regulatory agencies are currently directed by former bankers or bank attorneys, with the only exception being ex–Wall Streeter Alan Greenspan of the Fed.

5. The reforms recommended here call for a mandatory review and potential reform of CRA five years after the complete transition to the present reforms; if the reforms due out in 2002 are fully transitioned by the end of the following year, the next reform should occur in 2008.

6. The reforms recommended here will maintain the status quo of optional investment and service tests in the small-bank streamlined exam to improve a Satisfactory rating.

7. The only other test evaluated in this way was the lending test, for which 20 percent could not be evaluated; thus, the investment test is at least twice as problematic as the lending test in this regard.

8. This proposal should be viewed in light of the reputation of the bank's predecessor, First Union, as not being consumer- or CRA-friendly (see, for example, Thomas 1998).

9. According to the October 17, 2001 CRA reform comment of the Center for Community Change, only 14 of 9,821, or 0.1 percent of FDIC-insured institutions have chosen the strategic option plan.

10. The fact that the new heads of both the OTS and FDIC are ex-bankers is not unimportant, because the end result of the current activities may be a regulatory-distorted CRA Triangle like that seen in Figure 2.

Glossary

AA	assessment area
ANPR	Advanced Notice of Proposed Rulemaking
CD	community development
CRA	Community Reinvestment Act
FDIC	Federal Deposit Insurance Corporation
FED	Federal Reserve System
FFIEC	Federal Financial Institutions Examination Council
GLB	Gramm-Leach-Bliley Act
HMDA	Home Mortgage Disclosure Act
LMI	low-to-moderate-income
LPB	limited purpose bank
MBS	mortgage-backed securities
MSA	Metropolitan Statistical Area
NCRC	National Community Reinvestment Coalition
OCC	Office of the Comptroller of the Currency (U.S. Department of the Treasury)
OIG	Office of Inspector General
OTS	Office of Thrift Supervision (U.S. Department of the Treasury)
PE	Performance Evaluation
WB	wholesale bank

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