WRITTEN STATEMENT OF

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Mr. Chairman and members of the Committee, I commend you for your leadership in holding this hearing to discuss the Community Reinvestment Act (CRA), and to consider enhancements that will advance the cause of equitable credit availability, promote sound lending practices, and otherwise ensure that banking services are readily available to underserved communities.

Nearly thirty-three years have passed since the CRA became law, and in that time it has done great and measurable good. At the same time, since its passage, and particularly in the past three years, we have witnessed extraordinary changes in finance. The implosion in subprime lending that began in the middle of the last decade was only a foretaste of a full-fledged, global financial crisis from which we are just beginning to emerge. We are still in the midst of teasing out the lessons from that crisis. The task today is a worthy one— to look at whether CRA lending figured into what went wrong in finance generally, and examine how the CRA can be part of setting our financial system right.

Although the CRA has been the law for decades, it has always attracted its fair share of debate. Bankers have sometimes criticized the CRA as unnecessary and burdensome, particularly to small banks. That criticism was more prevalent before the Clinton Administration's 1994 regulatory reforms of the CRA, which—as the 27th Comptroller of the Currency—it was my privilege to lead. Our efforts resulted in banks committing more new money to CRA lending than they had committed over the entire period since the passage of the Act in 1977. We accomplished this by eliminating unnecessary burdens on banks and by assessing actual performance. I might add that the credit made available to low and moderate income Americans through CRA programs during this era— the 1990s—was not only transforming for low- and moderate-income communities, but it was almost without exception profitable and safe.

More recently, the CRA's supporters have argued the CRA has not fulfilled its potential, because regulators have failed to enforce it aggressively.

At the same time, a handful of critics have argued, incorrectly, that the CRA led to the subprime lending crisis, because it pressured banks to lend to people with insufficient income and against properties that lacked enough value to collateralize the loan. Nothing could be further from the truth. I will address this in detail in my testimony, but in short, the subprime crisis resulted from practices that were the antithesis of CRA lending. Unregulated mortgage brokers who are not subject to the CRA or bank regulation originated a high volume of high-interest rate loans. The moral and social imperatives that underlie the CRA were disregarded by opportunists who swarmed into mortgage lending, unfettered by the obligations of insured financial institutions.

I am, as you have discerned by now, a staunch defender of the CRA. But that is not to say that I believe it is without flaws. We need to rethink several dimensions of the law to bring it into sync with the new realities of the modern US financial system. I will address my specific recommendations in this testimony. But first, I would like to consider the historical underpinnings of the CRA.

History, as always, is instructive in understanding how we came to be at a new crossroads in the decades-long debate over CRA. It is worth remembering that not terribly long ago, credit was only for the wealthy and powerful. Prior to the 1920s, regulators prohibited banks, including national banks, from making mortgage loans to consumers because they believed such loans were not safe. The push towards the broad-based availability of credit, however, is what has made possible the sustained prosperity that we have known throughout most of the post-World War II period. Whether it is the promise of home ownership, a college education, or a loan to start a new business, when made prudently and used responsibly, credit put in the hands of consumers and small businesses— including low-and-moderate income borrowers—is a powerful tool to better their lives. The successes that Nobel Peace Prize winner Muhammad Yunus, founder of Grameen Bank; Fazle Abed, creator of BRAC, a now global Bangladesh-based micro financing operation; Ingrid Munro, founder of Jamii Bora, a financing operation that works with the poor in Nairobi, Kenya; and a host of others is testament to the power of creative and responsible lending.

To be sure, while credit can be a powerful tool for good, it can also be misused. Some argue that lending to low- and moderate-income (LMI) borrowers is too risky and is to blame for mushrooming numbers of home foreclosures. But our boom and bust of credit cycles have little to do with lending to LMI borrowers. Rather, they are the result of both the natural tendency of financial markets to swing to excess and then bust, and to the fact that financial innovation often produces an immediate surge where the controls come off, ending in grief.

We also must recognize that the economic crisis must change our preconceptions of who LMI borrowers are and where they live. High rates of unemployment are swelling the ranks of LMI borrowers in every state; the duration of unemployment is now the longest since the government began keeping records in 1948. LMI borrowers increasingly are not racial minorities living in inner cities. Many of these unfortunate victims of the recession had been good credit risks until recently. Few of them had any role in creating the economic crisis.

The need to make job-creating investments in communities across the country makes CRA an essential tool to spur a sustainable economic recovery. The business sector will lead the way out of this deep recession, but channeling money to Wall Street will not get capital where we need it most. It is small business that will create large numbers of jobs in communities throughout the country. And the growth of small business depends on support from local lenders. Banks and finance companies will determine the rate of job creation.

I begin my testimony with a retrospective on the CRA and past reform efforts. Then, I offer some observations regarding the role of credit to consumers in causing the current crisis. And I close with some thoughts on needed improvements in consumer protections and credit policies.

A History of the CRA

There is, perhaps, no legislation enacted by the Congress over that past thirty years that is more misunderstood than the CRA. As this Committee knows, the Act is short and simple. It asks that banks lend into the communities they serve, and it expressly instructs banks to only make sound loans.

Senator William Proxmire, who led the effort to enact the CRA, recognized that the revival of inner cities depended on the availability of credit. Congress banned racial discrimination in lending in the Fair Housing Act in 1968 and in the Equal Credit Opportunity Act of 1974. Despite these measures, Congress found that it needed to outlaw redlining[1] as well, because lenders were engaging in "neighborhood discrimination," in which lenders would deny mortgages to applicants based on the

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[1] Beginning in 1935, the Home Owners' Loan Corporation (at the behest of the Federal Home Loan Bank Board) in collaboration with private organizations developed maps that rated areas in and around larger American cities for mortgage lending risk. The supposedly "riskiest" (often having a remarkable equivalency to minority) neighborhoods were outlined in red. Private lenders used these maps as guides to determine where they should lend or not lend, and as a consequence, lending decisions for homes in supposedly high risk areas were not based on the income of the individual, but on the neighborhood in which the person lived.

neighborhood in which the property was located, not on the creditworthiness of an individual borrower.[2] The CRA was included in the Housing and Community Development Act of 1977 and was signed into law by President Jimmy Carter on October 12, 1977.

The question that troubled critics then – and troubles them now – is why would banks choose to ignore profitable lending opportunities? Studies show that banks, like most businesses, go after the low hanging fruit. Lang and Nakamura (1993) and Ling and Wachter (1998) find that banks have an initial informational barrier to overcome.[3] If one bank found successful lending opportunities in an area, others soon followed. Furthermore, some banks may choose to free-ride on the efforts of others and to cherry-pick the easiest lending opportunities. Racial discrimination also comes into play. Avery et al. (1993) found that lower levels of lending to blacks could not be fully explained by income and wealth.[4]

Some argue that the CRA is the wrong way to increase the flow of credit to communities. For example, Senator Robert B. Morgan, who led the opposition to the CRA, said he supported the "ultimate intent" of the CRA, which was "to assure that the credit needs of the inner city are adequately met." He argued that if it were effective, the CRA would amount to credit allocation, but if it failed, it would only discourage inner-city lending.[5] In response to such concerns regarding credit allocation, the lending quotas mandated by early drafts of the Act were removed. The enacted version of the CRA does not state the amount or the manner by which financial institutions should fulfill their community obligations, leaving a good deal of flexibility for the institutions and their regulators to determine the details of CRA compliance programs. Anticipating critics' charge that the CRA forces institutions to make bad loans, the Act explicitly provides that CRA lending should be "consistent with the safe and sound operation of such institution."[6]

The Congress only applied the CRA to banks and thrifts.[7] It reasoned that these institutions already have a "continuing and affirmative obligation to help meet the credit needs of the local

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[2] 15 U.S.C. §§1691 et seq. and 42 U.S.C §§ 3601 et seq.

[3] Lang, William W., and Leonard I. Nakamura (1993). "A Model of Redlining," *Journal of Urban Economics*, vol. 33 (Spring), pp.223-34 and Ling, David C., and Susan M. Wachter (1998). "Information Externalities and Home Mortgage Underwriting," *Journal of Urban Economics*, vol. 44 (November), pp. 317-32.

[4] Avery, Robert B., Patricia E. Beeson, and Mark S. Sniderman. "Account for Racial Differences in Housing Credit Markets," Working Paper 9310. Cleveland: Federal Reserve Bank of Cleveland, December 1993.

[5] 123 Cong. Rec. H8653 (daily ed. Jun. 6, 1977)

[6] 12 U.S.C. §2901

[7] Ibid.

communities in which they are chartered, consistent with the safe and sound operation of such institution."[8] Also, banks and thrifts were deemed to have an obligation to lend in their neighborhoods owing to the government's grant of a charter that confers special privileges, such as protection from competition and access to the federal safety net, including low-cost deposit insurance from the Federal Deposit Insurance Commission ("FDIC") and inexpensive credit from the Federal Reserve Banks and the Federal Home Loan Banks.[9]

Amendments to the CRA

Since its passage in 1977, Congress has amended the CRA several times. The first revisions took place as part of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"), which required regulatory agencies to make public their CRA evaluations and ratings.[10] Two years later, Congress passed the Federal Deposit Insurance Corporation Improvement Act of 1991, which expanded the regulators' information disclosure requirements to include publication of both the data and the factual findings used to support the rating assigned to an institution. In making these changes, Congress sought to promote greater uniformity and transparency in CRA examinations and ratings, as activists complained that it was nearly impossible to determine regulators' assessment criteria or to monitor an institution's CRA performance. [11]

Following the FIRREA amendments to the CRA, regulators adopted a more descriptive four-level ratings scale: Outstanding, Satisfactory, Needs to Improve, and Substantial Noncompliance.[12] Ironically, this new rating scheme in the view of some community activists compressed ratings and made it more difficult to differentiate between mediocre, good and excellent ratings.[13] However, there was a shift in the distribution of ratings following the rule change, with a larger proportion of institutions receiving below-

[8] Ibid.

[9] Marsico, Richard D. *Democratizing Capital: The History, Law, and Reform of the Community Reinvestment Act.* Durham: Carolina Academic Press, 2005.

[10] United States General Accounting Office (US GAO). "Community Reinvestment Act: Challenges Remain to Successfully Implement CRA." Report to Congressional Requesters GAO/GGD-96-23. Washington, D.C.: November, 1995.

[11] Marsico (2005).

[12] Thomas, Kenneth H. "CRA's 25th Anniversary: The Past, Present and Future." Working Paper No. 346. The Levy Economics Institute of Bard College: June 2002.

[13] Thomas, Kenneth. *Community Reinvestment Performance*. Chicago: Probus Publishing, 1993.

average ratings than before, indicating that regulators were becoming more rigorous in their examinations.[14]

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 made more significant changes. Up to this point, it was unclear that a bank had much at stake in CRA assessments. Since banks needed to get a Satisfactory rating for regulatory approval of interstate branches, Riegle-Neal augmented community activists' leverage to extract CRA lending commitments. (Today, most banks that needed to branch interstate have long since done so.)

The Gramm-Leach-Bliley Act of 1999 ("GLBA") included several revisions to the CRA legislation. It requires that a banking firm and all of its subsidiaries receive and maintain CRA ratings of Satisfactory or higher to have a financial holding company and engage in expanded financial activities. Likewise, national banks need to receive and maintain at least a Satisfactory rating to establish and maintain a financial subsidiary, which a bank must do if it wants to conduct securities business. At the same time, GLBA prohibits agencies from performing CRA examinations at institutions with less than $250 million in assets or that are affiliated with a holding company with less than $1 billion in assets.[15] This has significantly reduced the number of CRA examinations. Apgar and Duda (2003) found that less than 30 percent of all residential mortgage loans were subject to CRA review in 2003.[16]

The 1995 Regulatory Reform

In 1995, regulators substantially changed the way the CRA is administered. Pre-1995, CRA examiners assessed performance based on twelve factors and then rated institutions on a five-point scale, where "1" was the highest possible grade and "5" the lowest. These ratings were opaque, subjective, and inconsistent; for instance, the Federal Home Loan Bank Board, the former thrift regulator, considered 3 to be Satisfactory while the three other federal bank regulators required a 2 rating for a bank's CRA performance to be considered adequate. [17]

Not many institutions received low CRA ratings, and those that did seemed to suffer few consequences. It was extremely rare for a regulator to deny an application for a branch or a merger based

[14] Ibid

[15] Marsico(2005).

[16] Apgar, William C. and Mark Duda. "The Twenty-Fifth Anniversary of the Community Reinvestment Act: Past Accomplishments and Future Regulatory Challenges." *FRBNY Economic Policy Review*: June, 2003.

[17] Thomas (2002).

on an institution's CRA rating; Thomas (1993) found only eleven CRA denials out of more than 50,000 branch and merger applications between 1977 and 1989.[18]

Both regulated financial institutions and the CRA's supporters complained that enforcement was too subjective and bureaucratic, and that the examinations focused too much on process – primarily evaluating institutions based on their plans for LMI lending instead of actual lending performance.[19] In response to these criticisms, President Clinton asked the regulatory agencies in July 1993 to reform the way in which they implemented the CRA, in order to provide more standardized and objective assessments that emphasized lending performance and to make sanctions against noncompliant institutions more effective.[20] The President's goals were to:

1. Promote consistency and evenhandedness in CRA enforcement,
2. Improve public CRA performance evaluations,
3. Implement more effective sanctions, and
4. Develop more objective, performance-based CRA assessment standards.[21]

As Comptroller of the Currency, I headed the interagency review effort, which was the first comprehensive assessment since the passage of the Act sixteen years earlier. The Office of the Comptroller of the Currency and other agencies held multiple hearings in cities from coast to coast in order to gauge public reaction to the CRA, its effectiveness and its burden, and to solicit suggestions for its improvement. Thousands of pages of comments were submitted and reviewed, and the heads of the relevant agencies were personally involved in the creation of the proposed rule, sent out for comment in 1994, and in the creation of the final rule. In April 1995, the agencies released the final, revised interagency regulations. The regulations changed the system of assessment from one that was heavily subjective and paper based to one that was more objective and deemphasized form over substance compliance. The revised regulations also tailored the examination approach so that evaluations took into account the institution's size and business strategy.[22] These examination models are still used today:

[18] Thomas (1993)

[19] Board of Governors of the Federal Reserve System. "The Performance and Profitability of CRA-Related Lending." Report to Congress. Washington, D.C.: July, 2000.

[20] Board of Governors (2000) and Apgar and Duda (2003).

[21] Thomas (2002).

[22] Board of Governors (2000).

- The first model is a basic assessment for smaller retail institutions, which measures four lending ratios.
- A second type of examination is applied to large retail banks, which consists of rigorous tests to evaluate lending, investment, and service.
- The third model is given to wholesale or limited-purpose community institutions. Those institutions are permitted to select the criterion under which they are to be evaluated: community development ("CD") lending, CD investments, and/or CD services.
- The fourth model is the "strategic plan" examination, available to firms of any size, where an institution determines its own lending, investment or service performance standards.[23]
- Under all models, each institution is evaluated within its "performance context," which reflects the institution's characteristics, including its products and business model, its peers, its competitors, its market, and the economic and demographic features of its assessment areas.
- Retail institutions are evaluated on their performance within their assessment areas, but wholesale institutions can be assessed based on their efforts nationwide.[24]

Impact of the CRA

Most studies find that the initial version of the Act only resulted in a modest increase in lending, in spite the fact that the vast majority of institutions received at least a Satisfactory rating. The amendments to the Act in the early- to mid-1990s made the ratings more transparent and increased the incentives for larger banks to achieve at least a satisfactory rating. But it was the 1995 interagency revisions to the CRA regulations that had the biggest impact on increasing CRA lending. Just as importantly, they reduced paperwork burdens on banks.

The changes made to the CRA in the 1990s coincided with a rise in CRA lending commitments from an annual commitment of $1.6 billion in 1990 to $103 billion in 1999. In 1998, a year that saw three megamergers, CRA commitments reached $812 billion.[25] [26] CRA lending volume increased greatly

[23] Thomas (2002).

[24] Board of Governors (2000).

[25] National Community Reinvestment Coalition. "CRA Commitments," Washington, D.C.: September, 2007.

between 1993 and 2000. [27] The number of CRA-eligible home purchase loans originated by CRA lenders and their affiliates rose from 462,000 to 1.3 million.[28]

CRA grading by the regulatory agencies became tougher. Above-average ratings were at 27 percent prior to the 1995 reforms, and this fell to around 10 percent though 2001. Below-average ratings continued to hover around 2 to 4 percent even after the reforms.

One of the most comprehensive studies on the CRA's effectiveness was conducted by the Joint Center for Housing Studies at Harvard University (2002) over a period of two years, using enriched HMDA data to evaluate the CRA's performance between 1993 and 2000. The researchers found that the CRA-regulated financial institutions operating in their assessment areas outstripped non-covered or out-of-area lenders in originating conventional, conforming prime mortgages to CRA-eligible borrowers. Their multivariate statistical analyses confirmed that CRA lenders originated more home purchase loans to lower-income people and in LMI communities, and acquired a greater proportion of the LMI loan market than they would have without the influence of the CRA. [29]

Other studies find that the CRA has been effective in encouraging financial institutions to lend to redlined neighborhoods. Several statistical analyses conclude that the CRA had a positive influence in encouraging lending to LMI borrowers and in LMI neighborhoods. Litan et al. (2001) estimated that the CRA may have accounted for up to 20 percent of the growth in LMI lending among CRA lenders, and that CRA lenders were more likely to originate prime loans to LMI borrowers than were non-CRA lenders.[30] Avery et al. (1999) and Apgar and Duda (2003) concluded that the CRA has expanded lending and service to LMI individuals and neighborhoods, the former finding that this was especially true for consolidating organizations, and the latter finding that CRA lenders operating within their assessment

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[26] Regulators did not publish that information prior to the 1989 passage of FIRREA. According to the GAO, statistics on early CRA enforcement actions and ratings are unavailable.

[27] Factors other than the CRA reforms per se may also have contributed to this increase, including a strong economy, low interest rates, the development of credit scoring models, which reduced processing costs, as well as the increased use of securitization and the maturing of the secondary market, which enabled depository institutions to increase their mortgage lending volumes beyond their core deposit base and allowed non-depository mortgage financing companies to grow their lending activities.

[28] Litan, Robert E. et al. "The Community Reinvestment Act After Financial Modernization: A Final Report." Department of the Treasury: January, 2001 and Joint Center for Housing Studies. "The 25th Anniversary of the Community Reinvestment Act: Access to Capital in an Evolving Financial Services System." Harvard University: March, 2002.

[29] Joint Center for Housing Studies (2002).

[30] Litan, Robert E. et al. "The Community Reinvestment Act After Financial Modernization: A Final Report." Department of the Treasury: January, 2001.

areas made a larger share of prime, conventional loans to CRA-eligible borrowers than either CRA lenders operating outside their assessment areas and non-CRA lenders.[31]

In addition, studies find that lending to lower-LMI and minority borrowers increased at a faster pace than lending to higher-income borrowers; Avery et al. (1999) found that lending to low-income borrowers increased by about 31 percent between 1993 and 1997, while lending to higher-income borrowers increased only 18 percent over the same period.[32] The number of home purchase loans made to residents of low-income neighborhoods increased 43 percent, while lending to high-income neighborhoods rose only 17 percent.[33] Moreover, Barr (2005) found that homeownership in LMI areas increased by 26 percent between 1990 and 2000, whereas it increased only 14 percent in high-income areas during the same period.[34]

The profitability of CRA lending is another area that has been studied by scholars over the past couple of decades, as the statute requires CRA lending to be safe and sound. Studies generally concur that CRA loans are profitable, although often less so than standard loans. Meeker and Myers (1996) carried out a national survey of banks, savings and loans institutions, and bank holding companies with mortgage subsidiaries. Almost all said CRA lending was profitable, although a significant proportion noted that it was less so than other types of loans. However, the researchers were only able to obtain a response rate of 16 percent to their survey and the sample of responses was not randomly selected.[35]

In a more recent survey, the Federal Reserve Board of Governors (2000) contacted the largest CRA-covered retail lending institutions. Eighty-two percent of respondents reported that CRA home purchase and refinancing loans were profitable and 56 percent reported that CRA loans were generally as profitable as other home purchasing and refinancing loans. However, 51 percent of institutions stated that CRA loans had a higher delinquency rate relative to that of all loans, although 69 percent indicated that actual charge-offs for CRA loans were either no different from, or were lower than, the rate for other

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[31] Avery, Robert B. et al. "Trends in Home Purchase Lending: Consolidation and the Community Reinvestment Act." Federal Reserve Bulletin: February, 1999 and Apgar and Duda (2003)

[32] Avery et al. (1999).

[33] Laderman, Liz. "Has the CRA Increased Lending for Low-Income Home Purchases?" FRBSF Economic Letter 2004-16: June 25, 2004.

[34] Barr, Michael S. "Credit Where it Counts: The Community Reinvestment Act and its Critics." *New York University Law Review* 75.600 (2005).

[35] Meeker, Larry and Forest Myers. "Community Reinvestment Act lending: Is it profitable?" *Financial Industry Perspectives*. Federal Reserve Bank of Kansas City: Dec., 1996.

loans. These results may be skewed by nonresponse bias, as only 29 percent or 143 of the original sample of 500 institutions provided responses. Moreover the findings may not apply to smaller institutions because the respondents were large institutions, accounting for 40 to 55 percent of all CRA-loan originations at the time.[36]

There is a study by Jeffrey Gunther, often cited by critics of the CRA, which concludes the costs of the CRA exceed its benefits. Gunther attributes the growth in LMI lending between 1993 and 1997 to: 1) the removal or loosening of unnecessary regulations, such as interest rate and geographic restrictions; 2) a reduction in information costs due to automation and improved communications technologies; and 3) the development of better relationships between real estate developers and neighborhood associations. He finds that that LMI lending at non-CRA institutions, such as credit unions and independent mortgage companies, grew faster than at CRA-covered institutions. Gunther says the LMI-share of the lending portfolios at non-CRA firms increased from 11 percent in 1993 to 14.3 percent in 1997, whereas that of CRA lenders remained at approximately 11.5 percent over the same period, adding that non-CRA lenders accounted for slightly less than 40 percent of all one- to four-family home purchase loans originated in LMI neighborhoods in 1997. All this leads Gunther to conclude that because non-CRA lenders tend to be subject to fewer regulatory restrictions than their CRA counterparts, the loosening of regulations must be the major reason for the increase in volume of LMI lending.[37]

Gunther also argues that the CRA imposes costs by encouraging institutions to take on additional credit risk. He finds that higher CRA lending levels are positively correlated to a problem CAMELS rating, defined as a "3" or higher, but negatively correlated with a problem CRA rating. He also observes a positive correlation between LMI lending volume and a problem CAMELS rating, but finds no statistical relationship between LMI volume and problem CRA ratings. Finally, Gunther finds a positive relationship between reductions in profitability and both problem CAMELS ratings and problem CRA ratings.[38]

Gunther's evidence is not persuasive. While it is true that non-CRA lenders increased their share of subprime/CRA lending to 40 percent, they increased their share of all one- to four-family mortgage originations to 56 percent, an even higher percentage, demonstrating that these lenders did not increase

[36] Board of Governors (2000).

[37] Gunther, Jeffrey W. "Should CRA Stand for 'Community Redundancy Act'?" *Regulation* 23.3 (2000).

[38] Gunther (2000) and Joint Center for Housing Studies (2002).

their community lending by as much as their overall mortgage lending.[39] Gunther also has not differentiated between CRA loans by CRA lenders, which tend to be on fair and reasonable commercial terms, with predatory loans that are more likely to be made by companies that fall outside the jurisdiction of the CRA. In 2000, institutions subject to the CRA and operating within their assessment areas originated only 3 percent of subprime loans.[40] Further, Gunther fails to prove that increased CRA lending caused the lower CAMELS ratings. There are many reasons why an institution's CAMELS rating might decline, which are unrelated to the CRA. For example, CRA lending has tended to be a small part of the business of insured depositories. As we noted above, the institutions themselves say that charge-off rates for CRA loans are approximately equal to, or are lower than, those of all other loans, although the delinquency may be higher. Perhaps the biggest weaknesses with Gunther's study are that his findings are based on small institutions and his data are old. The ratings data are from the period between 1991 and 1996, so they do not reflect the impact of the 1995 rule revisions, which emphasize lending performance over process, would have become evident. Further, it's questionable whether results for small institutions can be extrapolated to large ones, because small banks have less incentive to establish a robust CRA program.

The CRA and the Subprime Loan Crisis

Some blame the CRA for the subprime lending crisis, in large part because they assume "CRA loans" and "subprime loans" are synonyms. They charge that the Act compels banks to lower their underwriting standards in order to make loans to people who live in LMI neighborhoods.

Subprime loans hardly existed before the early 1980s because, prior to that time, it was not legal for a bank to charge different interest rates depending on the risk, to make a variable interest rate loan, or to make a loan with balloon payments.[41] Furthermore, as noted above, a combination of redlining and lending discrimination further discouraged loans to low and moderate income Americans.

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[39] Joint Center for Housing Studies (2002).

[40] Joint Center for Housing Studies (2002).

[41] In 1980, the Depository Institutions Deregulation and Monetary Control Act provided banks flexibility to set rates and fees for mortgages. And on 1982, the Alternative Mortgage Transaction Parity Act allowed banks to make variable rate mortgages and mortgages with balloon payments.

As recently as 1995, only about 10 percent of mortgage originations were subprime; by 1997 that number had grown to 14.5 percent.[42] The Asian debt crisis in 1998 prompted a massive repricing of risk by investors, which resulted in a large decline in the number of subprime originations; however, the business quickly recovered and, by 2002, the volume of subprime mortgages was growing faster than ever. Data from Inside Mortgage Finance show that subprime originations grew 56 percent between 2002 and 2003.[43]

Importantly, there are key differences between the subprime loans made after 2002 and the ones made during the 1990s, when all grades of subprime loans grew at approximately the same rate. According to Chomsisengphet and Pennington-Cross (2006), the growth in subprime loans between 2000 and 2003 was almost entirely in A-rated loans, the highest grade of subprime mortgages. In fact, the originations of lower grade subprime loans generally continued to decline slightly.[44]

In his book, *Subprime Mortgages*, the late Federal Reserve Governor Edward Gramlich argues that both market and regulatory developments explain the rapid growth in subprime loans. He points out that the emergence of credit scoring offered a more inclusive and less costly way to make loans. But investors' expanding appetite for Wall Street's subprime securitizations was an even more crucial factor. The percentage of subprime loans sold into securitizations grew from 28.4 percent in 1995 to 55.1 percent in 1998 to over 80 percent in 2006.[45]

On the regulatory side, Gramlich believes the CRA did play an unintended role in the increase in subprime lending, by legitimizing doing business in formerly red-lined neighborhoods.[46] For example, he points to a study by Immergluck and Wiles (1999), which finds that over half of subprime refinances were in census tracts that were largely African-American. Gramlich interprets this as an indication that some banks were targeting LMI neighborhoods in order to demonstrate they were serving the community.

In fact, regulators began to draw a material distinction between the modern subprime loan and a true CRA loan in the late 1990s and 2000s. In the early 1990s, one might have said that many CRA loans were "subprime" in the strictest sense of the term, meaning that borrowers in LMI areas tended to have

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[42] Source: Inside B&C lending.

[43] Chomsisengphet, Souphala and Anthony Pennington-Cross. "The Evolution of the Subprime Mortgage Market," *Federal Reserve Bank of St. Louis Review*: January/February 2006.

[44] Ibid.

[45] Source: Inside MBS &ABS and Inside B&C lending.

[46] Gramlich, Edward. *Subprime Mortgages*. Washington, D.C.: Urban Institute Press, 2007.

lower FICO scores. By the early 2000s it became clear that regulators used the term "subprime" differently from the term "CRA loan," and that the CRA lenders' practices in making CRA loans differed from those of non-CRA lenders lending in the LMI areas. The CRA lender making CRA loans tends to have a social, or at least a non-predatory, objective, as it is regulated and examined by the bank regulatory agencies. In contrast, subprime lending—particularly of the 2005 to 2007 vintage—evolved into something of a perversion of the goal of the CRA; it became a kind of red-lining in reverse. The non-bank non-CRA lender, or the modern subprime lender, is driven to sell as many high rate loans as they can, with no particular social motivation.

A study by Traiger & Hinckley LLP's (2008) finds evidence of the distinction between CRA lenders and subprime lenders in of 2006 HMDA data. They conclude that banking companies that made CRA loans in the fifteen most populous metropolitan statistical areas ("MSAs") were more conservative in their lending practices than lenders not covered by the CRA. It found that 59 percent of these banks were less likely to originate high-cost loans and when they did, the average interest rate was 51 basis points lower than the rate for prime loans. Interestingly, the banks that made CRA loans in high-population MSAs were 30 percent more likely to hold the high-cost CRA loans in portfolio than were banks and non-banks that lent elsewhere. This suggests that the CRA has encouraged banks that lend in populous MSAs to take a thoughtful approach to LMI lending, instead of simply moving further out the risk curve.[47]

Since 2000, the subprime mortgage market has evolved in a direction indicating that the CRA is not a significant factor in the subprime mortgage market. Gramlich calculated from HMDA data that, "Only one-third of CRA mortgage loans to low- and moderate- income have rates high enough to be considered subprime."[48] Moreover, an analysis of the HMDA data by ComplianceTech finds that in 2006, about 67 percent of subprime loans were upper- or middle-income borrowers; LMI borrowers received only about 28 percent.[49] Indeed, LMI borrowers received the smallest share of subprime mortgage loans in each year between 2004 (when more detailed HMDA data began to be collected) and

[47] Traiger & Hinckley LLP. *The Community Reinvestment Act: Act: A Welcome Anomaly in the Foreclosure Crisis and Addendum.* New York: Jan. 7, 2008

[48]Gramlich (2005), 25.

[49] Jourdain-Earl, Maurice. "The Demographic Impact of the Subprime Mortgage Meltdown." ComplianceTech: 2008.

2007. Since 2004, over half of subprime loans went to upper- and middle-income borrowers in non-LMI census tracts.[50]

Another indication the CRA is not the cause of the subprime crisis is that un- or under-regulated mortgage brokers played an increasingly large role in the origination of subprime mortgages. Most of these brokers are not owned by depository institutions or their affiliates, and so are not subject to the CRA. In 2004 and 2005, mortgage brokerage companies reported on more than 60 percent of all loans and applications under HMDA. Two-thirds of them were independent. According to the Federal Reserve, these independent brokers make 50 percent of all subprime loans.[51] If the CRA were a driving consideration for depositories, banks and thrifts would want to be the portals through which all LMI borrowers enter in order to ensure they receive full CRA credit for originating all qualifying loans.

As a case in point, Jim Rokakis, Treasurer of Cuyahoga County in Ohio noted that HMDA show that in 2005, when home purchase mortgage originations peaked in the Cleveland, Ohio area, that the vast majority those loans were made by un-regulated mortgage brokers. Citing a study by the Research and Advocacy Center, he said that in 2005, the biggest lender, Argent Mortgage, originated 18 percent of home purchase mortgages and that the next largest lender, Century Mortgage, originated approximately five percent. Although both firms—now defunct—were well-known originators of subprime loans, neither were subject to the CRA. Likewise, the 4th through the 6th largest lenders were not subject to the CRA. In fact, the CRA applied to only four of the top ten mortgage originators in the Cleveland area in 2005. All together, the regulated originators were only responsible for 15 percent of originations, amounting to 648 purchase mortgages. By way of comparison, home foreclosures in Cuyahoga County are on a pace to reach 15,000 for 2008. Rokakis concludes, "Did [the banks] make these loans to help their parent institutions' CRA ratings look better? Possibly. Did these 648 loans play a major role in the city's default and foreclosure crisis? Hardly."[52]

In fact, subprime mortgage lending has become a specialized segment of the mortgage business: "…[T]he market share of the top 25 firms making subprime loans grew from 39.3 percent in 1995 to over 90 percent in 2003."[53] As of July 2007, 34 percent of the top fifty residential mortgage originators,

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[50] *Ibid.*

[51] Executive Office of the President. *Economic Report of the President*. Washington D.C.: United States Government Printing Office, February 2008, Table B-76.

[52] Rokakis, Jim, "Turmoil in the U.S. Credit Markets: The Genesis of the Current Economic Crisis." Testimony before the Senate Committee on Banking, Housing & Urban Affairs, Washington DC, October 16, 2008.

[53] Chomsisengphet and Pennington-Cross (2006), 40.

measured in terms of the numbers of loans originated, were neither depository institutions nor owned by one of the fifty largest bank holding companies.[54] What's more, firms that originate subprime loans are concentrated in California. If the CRA were an overriding consideration, one would expect to see most large and regional banks competing in the subprime lending space in order to serve LMI borrowers, and it would be unlikely that subprime origination would be dominated by specialists located in California. The fact that firms not subject to the CRA have come to play such a prominent role in the subprime business suggests that firms are originating these types of loans to make money and not as a response to regulatory and/or social imperative.

In sum, the evidence shows that the emergence of securitization, loan risk pricing, and specialization is what caused the subprime mortgage market to grow. The CRA may have been one contributor to the growth, but certainly not a very important one.

Causes of the Subprime Crisis

If not the CRA, then what explains why banks and investors assumed too much credit risk? The answer is that in this most recent cycle, we had a combustible mixture of a governmental philosophy that allowed for negative savings, high liquidity, and minimal regulation; and of complex financial instruments that allowed risk to be sliced and diced and misunderstood. Much of the lending and financial excesses in this cycle were not low- and moderate-income borrowers, but upper-middle income borrowers who embraced sophisticated yet risky financial products.

The government failed to engage in sound macro-economic and financial regulatory to avoid credit spikes and busts that fuel unemployment and even force responsible borrowers into unemployment. Financiers maintained a view that housing prices would continue to rise and home values would fill the hole in the consumer's badly weakened financial statements. There were mortgage brokers and others who profited from pushing exotic loans to people who could ill afford to make the monthly payments when they readjusted. To top it off, we saw the emergence of what Nicolas P. Retsinas, Director of Harvard University's Joint Center for Housing Studies, referred to in a December 21, 2009, *Boston Globe* op-ed as "strategic defaulters." They are not LMI borrowers, and these defaulters are able but unwilling to pay. They would rather default on their mortgage obligations, viewing them as they would view a bad investment.

[54] Source: American Banker

Researchers, Mian and Sufi (2008) show that high demand for mortgage-backed securities ("MBS") led to the surge in subprime lending.[55] Investors under-priced the risk posed by subprime collateralized mortgage obligations ("CMOs"), while investment banks and very large commercial banks created new secondary instruments to boost rates of return by greatly increasing leverage and liquidity risk. When the housing-price bubble burst, massive write-downs of these highly leveraged secondary securities soon followed.

In the period between 2004 and 2006, interest rates were low and the yield curve relatively flat – in fact, at the end of 2005 and again in January 2006, the yield curve was inverted. Yield spreads were so low that investors were not being compensated for the risks they were assuming. Investors were aggressively seeking yield and saw subprime mortgages as the ticket. Many of them assumed that the default risk of subprime mortgages, although higher than that of prime mortgages, would be relatively low. Since the economy was stable, investors thought they could take advantage of a flat yield curve to increase their returns by financing long-term securities with cheap short-term debt. Wall Street issued more and more securitization products, greatly increasing the demand for originations of subprime loan. At the retail level, mortgage brokers were pleased to oblige, as they were paid based on the volume of loans they originated.

One consequence of the de-consolidation of the mortgage origination and the mortgage holding process is the emergence of an agency problem, which undoubtedly played an important role in the events leading up to the subprime crisis. When banks make and hold a loan, they have every incentive to make certain the screening and underwriting process is done properly. After all, they stand to lose otherwise. In the originate-to-distribute model that became overwhelmingly popular prior to the subprime crisis, the originator does not suffer loss if a borrower defaults, as it bears little, if any, of the cost of underwriting mistakes and misjudgments; instead, its income is typically based on the volume of loans it sells. Likewise, financial institutions that buy these loans do not have as strong an incentive to scrutinize the loans they sell into securitization as carefully as the ones they keep – instead, their income rises the more loans they can sell into securitization.

Keys et al. (2008) confirm the presence of these agency problems in their analysis of a sample of two million home purchase loans made between 2001 and 2006. They find that originators pushed borderline, but subpar, low-documentation loans over the minimum qualifying credit score. As a result, the group of loans that lay just *above* the cutoff score defaulted at a 20 percent higher rate than those just

[55] Mian, Atif and Amir Sufi, "The Consequences of Mortgage Credit Expansion: Evidence from the 2007 Mortgage Default Crisis." Working Paper. Chicago: University of Chicago, May 2008.

below it. They also find that the information available to mortgage-backed securities holders tends to understate the true risk of borrower default.[56]

Predictably, credit standards declined, especially in 2006. Federal Reserve Chairman Ben Bernanke summed up the analysis in testimony before Congress: "The originate-to-distribute model seems to have contributed to the loosening of underwriting standards in 2005 and 2006. When an originator sells a mortgage and its servicing rights, depending on the terms of the sale, much or all of the risks are passed on to the loan purchaser. Thus, originators who sell loans may have less incentive to undertake careful underwriting than if they kept the loans. Moreover, for some originators, fees tied to loan volume made loan sales a higher priority than loan quality. This misalignment of incentives, together with strong investor demand for securities with high yields, contributed to the weakening of underwriting standards."[57]

That said, the data show that the defaults of subprime mortgages, though quite problematic, are not by themselves high enough to cause a freeze in credit markets or to push the U.S. economy into recession territory. As of June 2008, the stock of subprime mortgages outstanding was roughly $2 trillion.[58] According to Standard and Poor's, the worst of the subprime mortgage vintages originated in the post-2000 period have ninety-day-plus delinquencies of 20 percent.[59] So seriously delinquent subprime mortgages make up about 1.25 percent of all home mortgages and, even when adding in all other nonperforming 1-4 family home mortgages, the overall ninety-day delinquency rate is lower than it was in the early 1990s.[60] And it is important to remember that many delinquent mortgages do not go into foreclosure. Demyanyk and Van Hemert (2008) forecast actual foreclosure rates at less than half of the sixty-day delinquency rate.[61]

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[56] Keys, Benjamin J. et al. "Did Securitization Lead to Lax Screening? Evidence from Subprime Loans." Working Paper. Athens: European Finance Association, April 2008.

[57] Bernanke, Ben S. "Subprime mortgage lending and mitigating foreclosures." Testimony before the Committee on Financial Services, U.S. House of Representatives, Washington D.C., Sept. 20, 2007.

[58] Congressional Budget Office. "Federal Housing Financial Regulatory Reform Act of 2008." Cost Estimate. Washington, D.C.: June, 2008.

[59] Standard and Poor's. "U.S. RMBS Subprime Securitization Volume Declines Amid More-Stringent Guidelines." *RMBS Trends*. New York: August 31, 2007.

[60] Source: FDIC

[61] Demyanyk. Yuliya and Otto Van Hemert. "Understanding the Subprime Mortgage Crisis." St. Louis: Federal Reserve Bank of St. Louis, Aug. 12, 2008.

Instead, a new and different kind of securitization, rather than traditional subprime mortgage securitizations, caused the meltdown in the credit markets. In effect, some on Wall Street created highly-leveraged bets predicated on the continued strong performance of traditional subprime mortgage-backed securities. Investment bankers morphed subprime mortgages into new and highly-complicated credit derivative products, many of which were based on subprime CMOs and other collateralized debt obligations, which they sold to banks and other investors worldwide. Unlike stocks, futures, or commodities, these securities were not subject to margin requirements, so banks and investors paid for these secondary securitizations almost entirely with borrowed short-term money. The resulting leverage raised the potential rate of return, but also magnified the negative impact of any diminution in value of the underlying mortgages. It was these highly-leveraged secondary and tertiary financial products that turned a problem into a crisis.

As defaults of underlying mortgages began to rise, this had cascading and magnifying effects, first on the subprime originators themselves, and then on the holders of these highly leveraged debt instruments. Many investors, realizing they had underpriced their risks, panicked. When investors pulled back, holders of the secondary and tertiary subprime securitizations were suddenly unable to roll over their debt. Many had no choice but to sell whatever assets they had – including these CMOs -- at deeply discounted prices, thereby further reducing asset values. The massive deleveraging we are all painfully experiencing today has its immediate roots in this massive, systemic margin call. Looking at the magnitude and source of the problem, one would have to conclude that CRA loans played at best a bit part in this global tragedy.

Yet another piece of evidence that the CRA is not the cause of the subprime problem is provided by the decline in the performance of the most recent vintage of subprime loans reported in the data. Standard and Poor's data show higher delinquency rates, measured on an absolute basis, for 2006 vintage loans than for earlier vintages.[62] Demyanyk and Hemert (2008) find that, after adjusting for factors such as housing-price appreciation and borrower credit rating, the average loan-to-value ratio increased while loan quality steadily declined between 2001 and 2006 – yet, the price spread between prime and subprime mortgages shrank. They attribute the declines in underwriting and in pricing to a "classic boom-bust scenario, in which unsustainable growth leads to the collapse of the market."[63]

[62]Standard and Poor's (2007) .

[63] Demyanyk and Van Hemert (2008), Abstract.

Thus, it is apparent that the increase in subprime defaults did not result from the CRA's inducing banks to reduce underwriting standards or under-price risk. Rather, investors' desire for higher investment yields and Wall Street's response pulled the non-CRA, unregulated mortgage market in that direction.[64]

Looking Forward

Achieving a sustainable recovery requires creating large numbers of jobs thought the country. And the pace of the recovery will be driven by growth in the business sector. That is because consumers remain highly burdened with debt and have limited capacity to buy; the persistent high level of unemployment is making them reluctant to spend.

Small businesses have created over 64 percent of new jobs over the past fifteen years.[65] This means that banks and finance companies will play a crucial role in determining how fast these businesses can grow. The best means the government has for assessing the performance of banks in meeting the credit needs of the communities they serve is the CRA.

Unfortunately, the CRA is not keeping up with innovations and trends in the financial industry, such as industry consolidation and non-depository lending, and this is eroding the Act's effectiveness. The financial services business and the manner in which financial products are structured, offered, delivered, and held by institutions and investors has fundamentally changed in the last thirty years. At the time Congress was debating the CRA, banks were the dominant financial services companies and were the dominant debt holders. The banking and thrift industries have been losing ground to other financial companies over the last thirty-five years, so that non-bank lenders now hold more credit-market debt than do banks and thrifts.

New technologies, financial innovation and increased economies of scale also have contributed greatly to the transformation of the financial services sector. Today, non-banks, including hedge funds and broker-dealers, are able to collect savings and investments efficiently from all over the country, and to amass them for large borrowers and large securities offerings. Individual investors participate in

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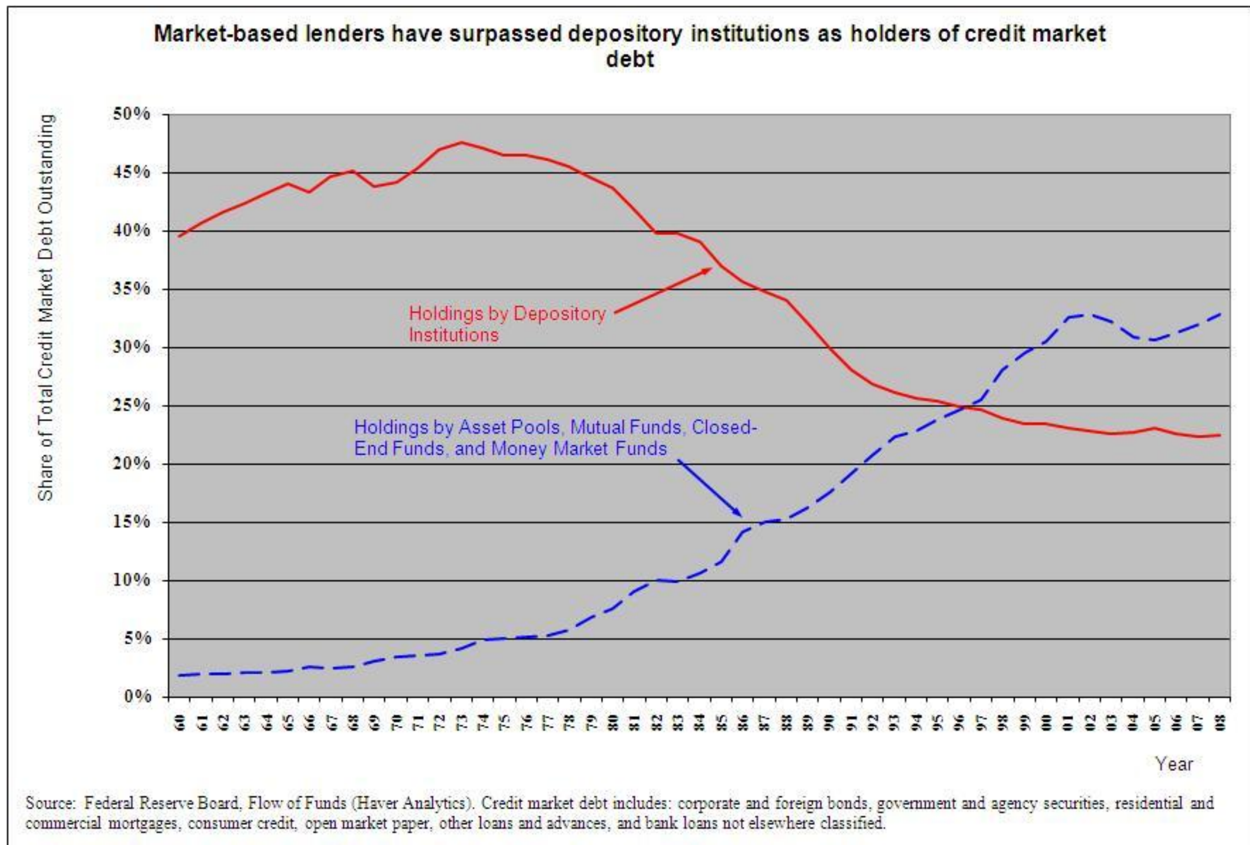
[64] The current financial turmoil continues to evolve. However, it is becoming clearer that the problem goes beyond subprime mortgages and that the originate-to-distribute model and other capital market ills have infected the prime mortgage market as well. Of course, the CRA has essentially nothing to do with the prime mortgage market. If this were a CRA-induced phenomenon, we would undoubtedly not see the same outcomes throughout the credit spectrum.

[65] Statistic reported by the Small Business Administration.

national capital markets via mutual funds, tax-deferred pension funds, hedge funds, private equity funds and so on – in so doing, they by-pass traditional intermediaries. Whereas in 1990, bank and thrift deposits exceeded mutual fund shares by $2.75 trillion, the amounts that each held were roughly equal by 2000.[66]



Market-based lenders have surpassed depository institutions as holders of credit market debt

Source: Federal Reserve Board, Flow of Funds (Haver Analytics). Credit market debt includes: corporate and foreign bonds, government and agency securities, residential and commercial mortgages, consumer credit, open market paper, other loans and advances, and bank loans not elsewhere classified.

The banking industry responded to these changes in a variety of ways, including consolidating into very large, multi-state banking companies. Community banks, with clearly defined service areas, have steadily lost market share to the big money center banks. Since 1992, banks with $100 million to $1 billion in assets saw their share of banking-system assets halve, from 19.4 percent to 9.5 percent.[67] Apgar and Duda (2003) found that mergers and acquisitions extended the geographic reach of many institutions, so that by 1998, more than 25 percent of banking assets were owned by firms headquartered out of state.[68]

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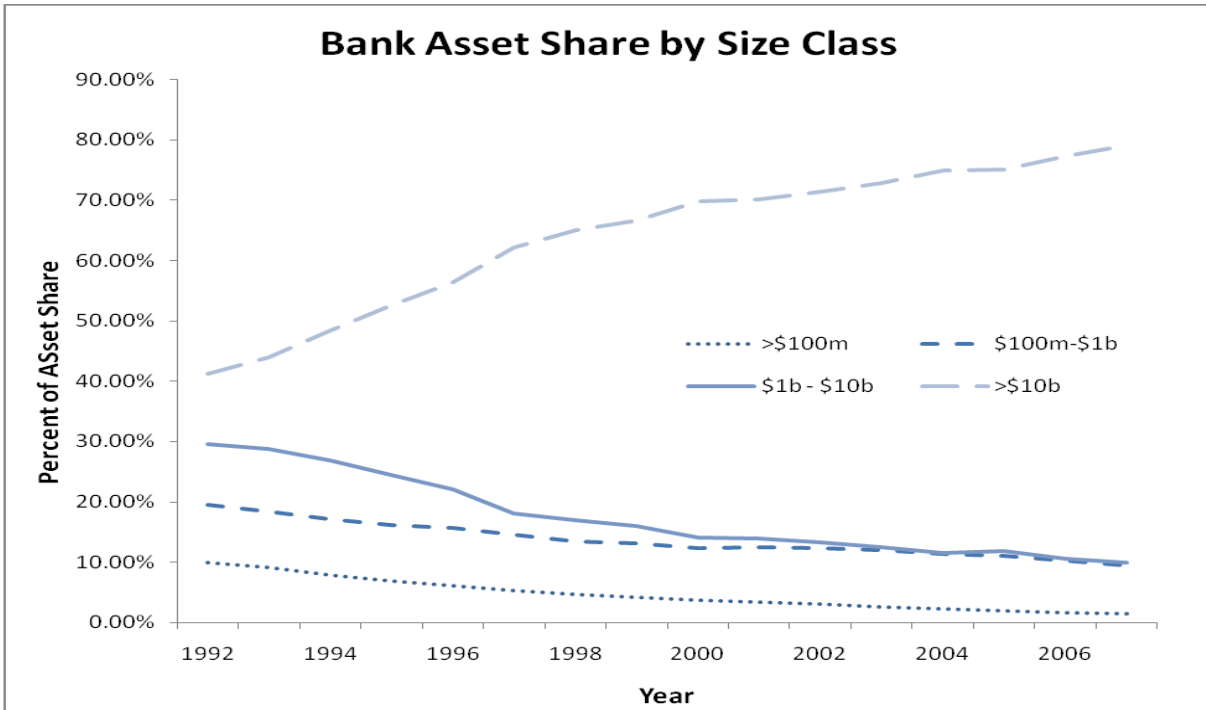
[66] Source: Federal Reserve Flow of Funds Data.

[67] Source: FDIC Call Reports.

[68] Avery et al. (1999).

In 2007, the average institution was twenty times larger than the average institution in 1977, and today, the ten largest banking companies hold over 67 percent of the assets in the banking system.[69]



One significant, but frequently ignored, consequence of the transformation to national financial markets is that local markets and local neighborhoods receive less individualized attention. As savings increasingly flow to large financial institutions and investment funds, investment becomes more focused on very large borrowers (both domestic and foreign). This is because large banks make loans most efficiently where the transactions costs per dollar are small. They tend to serve small borrowers with standardized loans and other products, such as lines of credit, mutual funds, and credit cards. To make money on non-standard loans — for example, by financing a start-up or a small business – requires knowledge of the borrower and experience with the local market, as well as close monitoring. A local banker or a specialized lender with knowledge of, or close proximity to, local borrowers can make individualized loans more cost-effectively.

[69] Source: Federal Reserve

A telling piece of supporting evidence is that community and regional banks more actively lend to projects that qualify for CRA credit. In 2001, banks with less than $1 billion in assets held only 16.8 percent of bank and thrift assets, but they extended about 28.2 percent of all CRA loans and more than 47 percent of CRA farm loans.[70] In fact, small business is highly dependent on community and regional banks for financing. In 2007, about 25.2 percent of commercial loans across the banking industry as a whole were in amounts less than $1 million. About 63.3 percent of the loans made by small banks were less than that amount.[71]

Recommendations for the CRA

Reigning in the excesses of subprime lending may have a disproportionate impact on LMI areas if lenders and investors take away the wrong lesson from the experience – that LMI borrowers are not good credit risks. In that case, vigorous application of the CRA is as necessary as it was in 1977, in order to ensure that there continues to be a flow of investment on fair terms to LMI neighborhoods. Indeed, inner cities and economically declining regions require large capital investment in infrastructure and the demolition or rehabilitation of dilapidated properties, if they are to be attractive environments for private capital investment. How, then, do we reconcile providing credit to the under-served while at the same time protecting consumers and the economy? I recommend the following:

1. Apply the obligation to meet the needs of LMI neighborhoods and communities to non-bank financial services companies. Their share of financial assets now exceeds those of banks and thrifts, and their holdings continue to grow. Furthermore, the Federal Reserve is in essence supporting almost all large financial services companies, regardless of charter, by giving them access to the safety net. Broker-dealers, insurance companies, and credit unions should be covered by the CRA, at a minimum. Ideally, it would also include all other major financial institutions important to the maintenance of a stable economy, such as hedge funds and private equity funds with more than $250 million in assets, consistent with the GLBA's small bank size cutoff.

   As well, an expansion of the concept of CRA to more squarely to include financial services broadly, not just credit, would help LMI individuals and geographies greatly. For example, where appropriate, an emphasis on making savings products more broadly available would

[70] Source: FFEIC.

[71] Source: FDIC Quarterly Banking Profile.

add value. In this regard, a CRA emphasis on some level of equity investment and innovation would also help LMI geographies and our economy more generally.

2. The holding company structure allows banks to reduce their CRA obligations by pushing activities out of the bank onto holding company affiliates; this has been going on for the past several years and is common in the mortgage and consumer lending areas. This anomaly needs to be rectified.

3. In many cases, the area served by a bank is no longer self-evident or defined by a geographic community. Virtually all of the top fifty banking companies have extensive interstate banking operations. Anchoring CRA obligations to the LMI area surrounding a charter or headquarters location does not reflect the reality of their businesses or their impact on LMI consumers. We need to assess whether institutions that conduct business in multiple states are reasonably distributing their CRA lending among the communities they serve. In some cases of national providers, a broad national approach to CRA is warranted.

4. In the current state of the economy, we should strongly encourage institutions to make loans that create permanent jobs in LMI census tracts. Lenders should receive CRA credit for loans to businesses that generate new jobs in LMI areas and additional credit, if the loan is to an LMI borrower.

5. We should consider granting CRA credit to lenders that establish effective loan programs for converting existing predatory loans to homeowners living in LMI census tracts into conventional loans.

Of course, the enhancements to the CRA I recommend will not be sufficient to satisfy the credit needs of LMI borrowers unless we also adopt a companion set of consumer protections. From the company store, to loan sharks, to pawn brokers, to tin men and unprincipled merchant lenders, quick buck artists have found ways to make money by taking advantage of the disadvantaged.

The evolution to global credit markets has made the financial services business more competitive, importantly driven by the rise of non-bank entities, and financial products have become more complex and sophisticated. In one sense, financial products have become less sensitive to the needs of LMI borrowers because LMI borrowers need to have greater financial sophistication to understand the risks these products pose. There are no better examples than the pay option ARMs and low-doc home mortgages that have been cultivated by the financial market's appetite for securitizable products.

The Congress should consider requiring regulators to:

1. Create appropriate underwriting practices tailored to the particular credit product. There is an enormous amount we have learned about lending responsibly and safely to low-and-moderate income borrowers that makes these loans a safe and sound credit practice – everything from rainy day reserves to credit counseling, to lending circles to more traditional income ratios and some down payment obligations.
2. Insist on disclosures to borrowers that are honest, simple, and understandable.
3. Prohibit, along with enforcement efforts that have teeth, practices – so prevalent in the past several years – of phony credit applications and real estate appraisals.
4. Police the un- and under-regulated providers of financial services.

Finally, we need to alter our national conversation about credit, placing a renewed emphasis on jobs and small businesses rather than homes. And we should study and learn from the successful practices that micro-credit and other experts have had around the world.

Conclusion

The CRA is not a panacea, but the CRA has proven it can help and help materially with the financial needs of individuals and communities. In the wake of the economic crisis these needs are as acute as ever.

The CRA needs to be modernized, but moving it into the 21st century requires the same kind of care and creativity that fostered the Act in 1977, and provided for its reform in the 1990s. The financial intermediation process, the structure of the banking system, and the methods for delivering financial services have changed in fundamental ways since 1977 in ways no one could have predicted when the CRA was enacted. The facts on the ground in LMI neighborhoods and communities have changed as well. Explicit redlining of neighborhoods by banks and thrifts is by and large a thing of the past. Innovations in technology and financial markets have lowered the cost of financing to the point that many more credit-worthy borrowers are able to access credit.

Yet, the heart of the problem that the CRA was intended to solve remains – that is, the need for the financial services sector to deliver enough support to local communities. They require sound infrastructure and healthy retail businesses. Academic studies still find evidence of information deficiencies, resulting in a more subtle, and perhaps unintended but still hurtful, form of redlining, which causes some banks to under-invest in some neighborhoods and to racial discrimination in lending. Critics

who argue that the subprime crisis demonstrates that the CRA is a misguided and unwarranted intervention by the government into the financial services sector are wrong. Thoughtful research by respected economists and community development experts show there are identified market failures that require government action to address.

I am confident that providing financial services (including credit) to low-and-moderate income borrowers can be reconciled with sound consumer and sound economic practices. What's more, its benefits are sweeping and tangible; and the results can clearly be seen within households, neighborhoods, cities and states throughout the country