Testimony of Calvin Bradford for the National People's Action
before the
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Subcommittee on Financial Institutions and Consumer Credit
Hearings on the Community Reinvestment Act
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Thank you, Chairman Gutierrerz, Mr. Hensarling, and members of this Committee for this chance to review the history of the Community Reinvestment Act (CRA), the performance of the federal agencies charged with the enforcement of the lending laws and the Community Reinvestment Act, and the need to update the Act to meet the needs and structure of today's financial markets. My name is Calvin Bradford. Over the past forty years, I have worked as an academic and policy analyst, a Senior Fellow at the Hubert Humphrey Institute of Public Affairs, and as an independent consultant and expert on housing and lending discrimination. My greatest pleasure, however, has been the position in which I come to you today as a board member of the National People's Action.

As you know, Mr. Chairman, the organizing that led to the CRA began in your home city of Chicago. Thirty-three years ago, I had the pleasure to work with Gale Cincotta and the National People's Action, Senator William Proxmire and his staff, and officials of the South Shore Bank in Chicago in drafting Senate Bill 406 - the Community Reinvestment Act.

As you focus a policy spotlight on the CRA to pursue the need to update the Act to meet the demands of the modern financial marketplace, you remind us of the incredible accomplishments that have come from trillions of dollars in reinvestment in low- and moderate-income and minority communities through the efforts of community-based organizations and development corporations in partnerships with local, regional, and national lenders.

In the beginning, the story of the Community Reinvestment Act is tale of the government providing for a role for citizens and the local community to shape their own path to economic revival and stability. In this respect, the public – community groups, consumer groups, civil rights groups - did their jobs well. But in the end, it is a story of the very agencies charged with protecting the citizens betraying the laws of Congress, perverting their own regulations and public pronouncements, and delivering the people of or nation into the greedy hands of unscrupulous mortgage lenders and Wall Street investment houses.

But, perhaps the ugliest chapter is being played out now, as the very working class and minority victims of this mass exploitation who for more than a decade waved warning flags about the coming disaster are being blamed by for the world financial meltdown by the defenders of Wall Street. I am not suggesting that community groups had analyzed the weaknesses of the hedge fund markets. I am suggesting something much simpler and more fundamental. While the complexities of the credit default swaps and other hedge fund maneuvers magnified the disaster, if the loans had been sound, reasonably well underwritten, and honestly marketed (and, if common sense had been applied to consider that all bubbles eventually burst), then the hedging wouldn't have been needed and the crisis would not have occurred. It was the community groups that attacked the basic weaknesses of the subprime market back when it began.

Given all that comes to light as we move toward regulatory reform, I will offer you the broad elements that NPA believes are essential to modernizing CRA so that it provides a basis for the future economic growth and stability in all communities with underserved financial needs and lagging local economies – urban and rural. In order to understand both the rationale and importance of these proposals, my written statement places these elements within the context of the past history and present conditions of the CRA, itself, and within the context of the current the financial markets. In doing this, however, one needs to comment, as well, on the misinformed – and at some points even racist - efforts to blame the CRA for the mortgage meltdown.

Facing the Realities of the Current Markets and Regulatory Environment

For the much simpler financial markets in which it was developed, the Community Reinvestment Act was designed to assure fair access to credit to all persons and all communities – and to serve as an engine for the creation of a development banking industry. Over the years since the Act was created, the markets have become more complex and simultaneously both more segmented and more fragmented. As the regulations for the Act have become more diffuse and lax, neither of the original goals of the Act is now being met.

The modernization of the Act needs to refocus on the original goals while taking account of the changes that have taken place in the financial markets. One critical aspect of those changes has been the increased development of loan products that are toxic either in their innate format or when concentrated in particular markets or communities. Another critical development has been the merging of banking, investment, and insurance services into a single bank holding company. A related development has been the dominance of Wall Street over the growth and proliferation of financial products. On Wall Street, the goal is not simply to invest, but to hedge those investments so that any market failures do not impact the investors. As a result, the goal of the investment community has detached itself from the welfare of the citizens. That is, what is good for Wall Street is not necessarily good for the public.

In the current meltdown, Wall Street's essential admission of any culpability is that it failed to hedge fully and soundly the risks resulting from its investments in unsound and toxic loans. In response, the structure of the regulatory reform efforts (aside from the effort to create the Consumer Finance Protection Agency [CFPA]) are aimed largely at ensuring some form of proper hedging – rather than at controlling the development or use of potentially toxic financial products. After all, increased capital requirements, for example, are basically a form of hedging, but in a different form than a credit default swap. In any event, the purpose is to protect the investor from the consequences of the investment and not to protect the public from the investment itself.

In the legislative arena, we now have a kind of skewed three legged stool developing in relation to support for community investment – which is really about getting the money to Main Street. First, in reality, regulation is focused on minimizing losses to the investors, whether they are banks, investment houses, insurance companies, or some hybrid. Second, it is the proposed Consumer Finance Protection Agency that would focus on identifying and, in some cases prohibiting, the use of products that are deceptive, misleading, or that are potentially toxic to either individuals or communities. Third, the Community Reinvestment Act is left as the main vehicle to provide fair access to sound financial products while holding financial institutions accountable for the impacts of toxic financial products.

In this model, the banking industry and Wall Street have at their disposal not only their own inherent power in the markets, but the ultimate support of their hedging values by the financial regulatory bodies themselves. The CFPA hangs by a thread in Congress. The real enforcement of the Community Reinvestment Act relies on the public and community-based organizations presently armed with very few, limited, and outdated tools. The CRA modernization, therefore, needs to face this reality.

A Brief Review of the Historical Context for the CRA

The Good

The Community Reinvestment Act grew out of the anti-redlining movement of the 1970s that was led by the National People's Action. The movement was a uniquely American effort to expand the role of the private banking industry in communities that had been underserved because of their racial composition, income levels, or because they were older and lagged behind the growing suburban communities preferred by the banks and savings institutions at that time. The movement was based on the premise that these underserved communities represented sound opportunities for profitable investments that were being overlooked. Sometimes these communities were overlooked because of a prejudice about the racial composition of the residents or simply about the age of the communities. In other ways, these communities were overlooked because the banking industry had failed to develop appropriate products, services, or skills that could open up new markets and revitalize these communities.

The CRA was based on the existing laws covering financial institutions that are chartered by the Federal government and/or that receive the substantial benefits and protections of deposit insurance. As Senator Proxmire noted in a letter circulated in December of 1976 with a draft of the CRA bill:

> The authority to operate new deposit facilities is given away free to successful applicants even though the authority conveys substantial economic benefit to the applicant. Those who obtain new deposit facilities receive a semi-exclusive

franchise to do business in a particular geographic area. The government limits the entry of other potential competitors into that area if such entry would unduly jeopardize existing financial institutions. … The government provides deposit insurance through the FDIC and the FSLIC [Federal Savings and Loan Insurance Corporation] with a financial backup from the U.S. Treasury. The government also provides ready access to low cost credit through the Federal Reserve Banks or the Federal Home Loan Banks.

In return for these benefits, financial institutions are required by law and regulatory policy to serve the "convenience and needs" of their communities as a condition for acquiring new deposit facilities. … However, in practice, the regulators have tended to ignore credit needs and have focused primarily on deposit needs.[1] The regulators have thus conferred substantial economic benefits on private institutions without extracting any meaningful quid pro quo for the public. … The proposed legislation directs the bank regulatory agencies to use their leverage in approving applications for deposit facilities in a way that will benefit local communities. … **The bill would not inject any radically new element into the deposit facility application and approval process already in place. Instead, it merely amplifies the "community need" criteria already contained in existing law and regulation and provides a more explicit statutory statement of what constitutes "community need"** (emphasis added).[2]

Therefore, the CRA was based on the existing processes for granting charters or approving acquisitions, mergers, and branching – and on the clear assumption that these activities are not a right, but are a privilege. The Community Reinvestment Act was intended to ensure that institutions that failed to meet the convenience and needs of their local communities would not be eligible for these financial privileges. Moreover, the CRA was intended to be one of the major tools in the eliminating of racial redlining and discrimination in lending.

While the Act did not specifically define the need to serve the needs of minorities or other protected classes, it did specifically require that lenders serve the needs of low- and moderate-income communities. Moreover, the regulations implementing the CRA required institutions to define a community service area in ways that were not discriminatory, to assess local credit needs, and to list the services that they intended to provide to the community. There was a specific assessment factor related to the definition of the service area. The Act stated that the lenders had a "continuing and affirmative obligation" to serve the needs of their communities. A clear role was created for members of the public to challenge applications for mergers, acquisitions and branches.

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[1] One of the main claims of the anti-redlining movement was that banks and savings institutions took the deposits from their communities and siphoned them off into the white and suburban communities.

[2] Draft of the Community Reinvestment Act attached to a letter from Senator Proxmire dated December 17, 1976.

When it became clear that neither the regulators nor the banking industry – both of whom had opposed the legislation – were going to take seriously the effort to develop programs to reinvest in underserved communities, community-based organizations and development corporations initiated their own reinvestment loan programs and challenged the lenders to participate. Today, there are many different and successful CRA programs and virtually all of them are variations of models first developed by community organizations in partnership with financial institutions.

Together, community action groups, the growing base of community-based development corporations, and the South Shore Bank in particular, provided both a political base for action and sound practical applications as support for making reinvestment part of the banking business. It is beyond the scope of these hearings to review the development banking side of the Community Reinvestment Act. We should note, however that the basis for such an industry exists and comes largely from the efforts of community-based initiatives and scores of negotiated community reinvestment agreements with individual lenders. The efforts to build a development banking industry have been frustrated in part by the fact that these agreements have never been recognized as formal obligations by the bank regulatory agencies and even though neither the regulatory agencies (including the Treasury Department), HUD, nor the Department of Commerce have ever taken seriously the role of building an economic development banking industry.[3]

While we have several programs to funnel private investment into lagging economic markets in foreign countries, the Community Reinvestment Act remains the singular program devoted to the creation of a development banking industry to serve America's own economically lagging communities. As the late Federal Reserve Governor Ed Gramlich noted several years ago, these reinvestment efforts resulted in over 3 trillion dollars in reinvestment. I have worked on both the creation and evaluation of reinvestment programs. I have watched once desolate abandoned communities being rebuilt through reinvestment. I have seen many financial institutions discover the value of private market opportunities in these communities – as it is the expansion of sound opportunities for the private financial markets that has always been the goal of the CRA.

The Bad

Aside from the act of voting, citizens have few opportunities to participate directly in public policy. The role originally given to the public in working with lenders and in challenging covered activities is one of the rare places where citizens can participate in the economic policies and practices that affect their lives and their communities. Over the years, however, revisions in the CRA regulations have weakened and undermined both the enforcement process and the role of the public and community.

[3] While we note the critical role played by Community Development Financial Institutions, isolating the skills and experience of such lending in separate institutions where the regulated lenders and the government provide support is not a replacement for the larger banking industry, itself, acquiring and developing these skills and this experience.

The revisions made to the regulations in 1995 represent the most critical abandonment of the regulatory oversight process. In the 1995 revisions to the CRA regulations, the agencies eliminated key aspects of the CRA enforcement. They eliminated the evaluation of the institution's assessment of community credit needs. In essence, they eliminated the role of the community and made the CRA process a private affair between the lender and the regulator. By what first appeared to be subtle changes in the delineation of the CRA assessment area, they actually "permitted" institutions to draw their CRA assessment areas in any way they pleased as long as the regulator could be convinced that it was a "reasonable" area for the institution to serve. In spite of some language about not discriminating and not excluding low- and moderate-income areas, what was reasonable was ultimately left to the subjective discretion of the examiner.

Above the Law: High CRA Ratings for Fair Lending Violations

When the CRA was first created, it was naturally assumed that lenders would be held accountable under the CRA for compliance with all fair lending laws. The Fair Housing Act already prohibited discrimination against minorities by lenders. In just the previous year (1976) in Ohio, the *Laufman* case had established that redlining was covered by the Fair Housing Act.[4] The Federal Home Loan Bank Board (FHLBB) had filed its own amicus brief in support of the decision in the *Laufman* case. The FHLBB was the regulator of the nation's largest savings and loans and mutual savings banks, which were the largest conventional home lenders at this time. Moreover, the Equal Credit Opportunity Act (ECOA) had just been passed in 1976, giving more direct prohibitions against racial discrimination in lending of any kind. Fair lending was clearly the law of the land already – and the bank regulatory agencies were mandated to affirmatively enforce the fair lending laws. Finally, there was the assessment factor in the regulations related to fair lending.

Immediately after the CRA was passed, HUD had contracted for a report on the likely impact of the CRA. The report includes sections on what the examination process should look like and what types of resources should be used in the examination process. At the beginning of the section on the examination of the institution's record is the statement, "The first almost elementary aspect of any assessment should be an evaluation of the lenders (sic) record under the Fair Housing Act, Equal Credit Opportunity Act, and related non-discrimination regulations. **A lender in violation of these provisions is, *a priori*, not meeting the needs of his community**" (emphasis added).[5]

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[4] *Laufman v. Oakley Building & Loan Co*., 404 F. Supp. 791 (S.D. Ohio 1975), 72 F.R.D 116 (S.D. Ohio 1976), and 408 F. Supp. 489 (S.D. Ohio 1976).

[5] Warren Dennis, "Working paper No. 24 - The Community Reinvestment Act of 1977 – Its Legislative History and Its Impact on Applications for Changes in Structure Made by Depository Institutions to The Four Federal Financial Supervisory Agencies", Credit Research Center, Krannert Graduate School of Management – Purdue University, 1978, under a contract with HUD, pages 80-81. In a foreshadowing of the problems that we are addressing today, the report warns that aside from the Federal Home Loan Bank Board, the bank regulatory agencies have little experience with fair lending enforcement and the understanding of the fair lending laws. The report even notes that "the Federal Reserve Board continues to contest its obligations under the Fair Housing Act."

For support for this statement, the report cites a no more convincing source than the testimony of the representative of the Federal Home Loan Bank Board at the hearings on Senate Bill 406. The report goes on to review how such anti-discrimination reviews can be done, also citing the hearings on Senate 406 regarding anti-redlining regulations in California that were developed for the savings and loan department there as part of its review of lending institutions. The report continues:

> Examiners should be given a program for analyzing Home Mortgage Disclosure Act data as an integral part of the CRA review. Loan locations should be plotted on race and income coded census tract maps, with overlays for the different types of loans on the report. This device gives the examiners a tool for reviewing the institution's designation of "market area" and spotting "gerrymandered neighborhoods."

But, from the beginning, the regulators claimed that the law only applied to serving "low- and moderate-income communities". Therefore, examiners did not review racial lending patterns as part of the CRA compliance process.

When the regulations were changed in 1996, the regulators eliminated the assessment factors related to evidence of illegal discrimination. What remained was simply an instruction to consider any evidence of discrimination after the examiner had used the new scoring system to assign the CRA rating. Unlike the formal assessment factors, there were no guidelines and no scores associated with the examiner's review of evidence of discrimination. There was only the instruction to consider any actions that the lender may have made to correct the problems. In a CRA system based on numerical scores, the assessment of discrimination effectively counted for nothing.

The effects of these changes can be seen in several cases where the regulators gave "Satisfactory" and "Outstanding" ratings to institutions that were sued by the Department of Justice (DOJ) for formally redlined minority communities. I have reviewed three cases where the Department of Justice sued major metropolitan institutions for discrimination in explicitly redlining the entire city of Detroit or the minority portions of Gary, Indiana, and Chicago while the regulatory agencies gave these same lenders high CRA marks. The agencies continued to reward these lenders by approving their applications for branches, mergers, and acquisitions while the redlined communities have continued to suffer from disinvestment and subprime abuses. I have also included one case where the lender was twice found in violation of the fair lending laws in Federal court and was rewarded by the regulatory agency by raising its grade to Outstanding and continuing to approve its applications for banking privileges.

The question, then, is how to explain the cases where the Department of Justice has filed discrimination claims against a lender or a lender has been found to have violated the fair lending laws in court while the regulatory agencies continue to give these institutions the high CRA ratings and continue to grant them branching, merging, and acquisition rights. A review of these cases illustrates the issue.

The OTS and Mid America Federal

The Chicago metropolitan area is the largest African-American home lending market in the United States, and one of the largest Hispanic markets outside of the Southwest as well. Mid America is the largest independent thrift institution in the entire Chicago market. It is one of the largest mortgage lenders in the Chicago markets. Mid America is regulated by the Office of Thrift Supervision (OTS). Since 1994, the OTS has given Mid America four Outstanding ratings and one Satisfactory rating.

In 2002, DOJ filed suit against Mid America for violating the Fair Housing Act and the Equal Credit Opportunity Act.[6] In specifically citing Section 228 of the CRA regulations (Reg BB), the suit stated that, "In establishing its assessment area, also known as its community service area, boundaries under the Community Reinvestment Act of 1977, 12 U.S.C. §§2901-2906 ("CRA"), Mid America has, since at least 1996, excluded nearly all predominantly African American and African American/Hispanic neighborhoods in the Chicago MSA, even those located in close proximity to its branch offices." [See the attached map which reproduces the exhibit from the DOJ complaint.]

Even though it was a major lender in the white communities along Lake Michigan in the City of Chicago and in the northern suburbs, it defined its assessment area largely as a suburban area west of Chicago. Essentially, Mid America eliminated the minority communities within the City of Chicago and the southern suburbs.

Even if the OTS ignored the racial composition of Chicago, the regulations require lenders not to exclude low- and moderate- income census tracts from their CRA communities. According to the 2000 census, 91% of the low- and moderate-income census tracts in the City of Chicago, for example, are also minority census tracts. Looked at from another perspective, 86% of all the minority census tracts in Chicago are also low- or moderate-income census tracts. Thus, for many years, the Office of Thrift Supervision has allowed this major Chicago metropolitan area lender to exclude both low- and moderate-income and minority areas from its defined service area.

The DOJ suit cites the pattern of expansion of Mid America through the opening of branches in the Chicago metropolitan area. The complaint states that, "Mid America has engaged in a race-based pattern of locating or acquiring new offices. It has located or acquired new branch and other offices to serve the residential lending and credit needs of predominantly white areas but not those of predominantly African American or African American/Hispanic neighborhoods. Mid America has never opened any new full-service branch office in a majority African American or African American/ Hispanic neighborhood. As of March 1, 2002, of Mid America's 33 branch offices, only one,

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[6] Copies of the complaints and consent decrees for this and the other DOJ cases cited in this statement can be found on the DOJ website at http://www.usdoj.gov/crt/housing/caselist.htm#lending.

Broadview, is located in a census tract in which a majority of the residents are African American. However, the Broadview branch is the only non-traditional office operated by Mid America. In contrast to all its other branch offices, the Bank's Broadview office consists solely of an ATM machine and a lobby area located inside a K Mart. Moreover, the level of services offered at the Broadview branch is substantially less than that offered at Mid America's other branches. Every other branch office offers mortgage lending or investment services, or both; neither is offered at the Broadview branch."

Opening branches is a privilege that should be granted only to institutions that have satisfied their CRA obligations. By continually allowing Mid America to expand, the OTS was rewarding a major lender in the nation's largest African-American mortgage market for engaging in racial redlining – the very practice that led to the creation of the CRA in the first place.

While DOJ settled the case by requiring the lender to open minority branches, to pay $10 million for special minority loans to compensate for past discrimination, and to develop outreach programs and to participate in existing special loan programs, the OTS still gave the lender a rating of Satisfactory after noting the lawsuit (the only rating below Outstanding that the OTS gave this lender since 1992). The OTS noted that in light of the lawsuit it could "not find the lender had not violated the fair lending laws". As the lender complied with the settlement order, the OTS gave the lender credit for expanded lending and raised the rating to Outstanding. Thus, the actions that Mid America was forced to take as the result of a consent order by a Federal court were used to raise its rating to Outstanding.

The Federal Reserve Board and Old Kent Bank

Between 1997 and 2001, the Federal Reserve Board had given three Satisfactory CRA ratings to Old Kent Bank, a major lender in the Detroit metropolitan area.[7] During this period, Old Kent defined its assessment area in terms of several counties and parts of counties that encircled the City of Detroit, but excluded the City of Detroit itself. A review of the Public CRA Evaluation reports indicates that the Federal Reserve Board was clearly aware of this exclusion and that it accepted this exclusion of Detroit and evaluated Old Kent based on the service it provided to the predominantly white suburban areas only.

In 2006, DOJ filed suit against Old Kent for violating the Fair Housing Act and the Equal Credit Opportunity Act. In specifically citing Section 228 of the CRA regulations (Reg BB), the suit stated that, "Instead of defining its assessment area in accordance with Regulation BB, Old Kent Bank circumscribed its lending area in the Detroit MSA to exclude most of the majority African American neighborhoods by excluding the City of Detroit." [See the attached map which reproduces the exhibit from the DOJ complaint.] The complaint also indicates that "As of March 2000, Old Kent Bank still did not have a single branch in the City of Detroit, where the population is more than 81% African American."

[7] The 2001 rating was given after the FRB had approved the merger of Old Kent into Fifth Third Bank.

Even if the Federal Reserve ignored the racial composition of Detroit, the regulations require lenders not to exclude low- and moderate- income census tracts from their CRA communities. According to the 2000 census, 93% of the low- and moderate-income tracts in Detroit, are also minority census tracts. Looked at from another perspective, 86% of all the minority census tracts in Detroit are also low- or moderate-income census tracts. Thus, for many years, the Federal Reserve Board had allowed this major Detroit metropolitan area lender to exclude both low- and moderate-income and minority areas from its defined service area.

The DOJ suit cites the pattern of expansion of Old Kent through the opening of branches in the Detroit metropolitan area. The complaint states that, "As of January 1996, Old Kent Bank operated at least 18 branches in the Detroit MSA. Not a single one of these branches was located in the City of Detroit. As of March 2000, Old Kent Bank had expanded its business presence in the Detroit MSA to include a branch network of at least 53 branches, located in every county of the Detroit MSA. Virtually all of Old Kent Bank's branches were located in predominantly white suburbs." Opening branches is a privilege that should be granted only to institutions that have satisfied their CRA obligations. By continually allowing Old Kent to expand (and by later allowing the merger of Old Kent and Fifth Third), the Federal Reserve Board was rewarding a major lender for engaging in racial redlining.

The DOJ complaint also cited Old Kent for failing to provide equal lending services for both home mortgage and small business loans to the minority areas that were illegally excluded from its CRA lending community. As a result, DOJ engaged in a consent order requiring corrective actions that had not been ordered by the Federal Reserve Board.

The FDIC and Centier Bank

Centier Bank is regulated by the FDIC. It serves a regional market in Northwest Indiana. The FDIC examined Centier four times between 1993 and 2003. Each time the bank was given a Satisfactory rating. This rating allowed the bank to continue to engage in branching and expansion activities which should have been denied had the institution been given a failing CRA rating. Indeed, it has become clear that even when community challenges are made, a passing CRA rating provides the lender with a safe harbor. Therefore, challenges become a fruitless gesture for lenders with passing CRA ratings – and almost all lenders have passing CRA ratings.

While Centier's delineated service area literally surrounded the City of Gary (a predominantly African-American city), through at least most of 1999, almost all of the City of Gary, and all of Gary's predominantly minority census tracts, were excluded from the delineated community. In this year (according to the DOJ complaint), "the FDIC informed the Bank that its assessment area violated the CRA and its regulations." Even at this point, the FDIC continued to give the bank a Satisfactory rating.

In 2006, DOJ filed suit against Centier for violating the Fair Housing Act and the Equal Credit Opportunity Act. In specifically citing Section 228 of the CRA regulations (Reg BB), the suits stated that, “Instead of defining its assessment area in accordance with Reg BB, Centier long circumscribed its lending area in the Gary PMSA to exclude most majority-minority neighborhoods, including having two geographically separate assessment areas for many years. Until late 1999, Centier’s CRA assessment area included only three majority-minority census tracts from Gary, East Chicago, and Hammond, despite the fact that a large number of minority tracts were adjacent to the non-minority tracts included in the assessment area.” [See the attached map which reproduces the exhibit from the DOJ complaint.]

According to the 2000 census, 93% of the low- and moderate-income tracts in Gary, Indiana, are also minority census tracts. Looked at from another perspective, 87% of all the minority census tracts in Gary are also low- or moderate-income census tracts. Thus, for many years, the FDIC had allowed this major Northwest Indiana lender to exclude both low- and moderate-income and minority areas from its defined service area. In allowing the institution to continue to open branches in the areas outside of Gary, the FDIC was actually rewarding Centier for its discrimination.

The DOJ complaint also cited Centier for failing to provide equal lending services for both home mortgage and small business loans to the minority areas that were illegally excluded from its CRA lending community. As a result, DOJ engaged in a consent order requiring corrective actions that had not been ordered by the FDIC.

First American Bank – Can You Pass the CRA by Switching Regulators?

First American Bank serves the markets of the Chicago and Kankakee MSAs in Illinois. In 2001, the Federal Reserve Board gave the First American Bank a Substantial Noncompliance rating based on evidence of illegal discrimination. That evidence was turned over to the Department of Justice. In July of 2004, DOJ filed suit against First American Bank for violating the Fair Housing Act and the Equal Credit Opportunity Act. First American Bank was accused of serving only predominantly white areas in its markets. This complaint was a pattern or practice case based on both marketing and lending. According to the complaint, this evidence included “comments made by American Bank officials to examiners from the Federal Reserve Bank of Chicago with respect to the Bank's lending practices which are based on racial and ethnic stereotypes.”

Meanwhile, First American Bank operated under a Cease and Desist Order from the Federal Reserve based on the prior evidence of discrimination. In November of 2003, First American Bank changed its regulator to the FDIC. In March of 2004, the FDIC gave First American Bank a Satisfactory rating, thus reinstating its privileges to engage in branching and other activities while the DOJ investigation was still ongoing. In July of 2004, four months *after* the passing CRA rating, DOJ settled the case with First American Bank with a series of remedial actions that were to be taken in the future to correct past discriminatory behavior. The FDIC public CRA evaluation mentioned the

Cease and Desist Order with the Federal Reserve, but did not mention the DOJ investigation.

While the analysis in the CRA public disclosure showed some signs of more lending in low- and moderate- income areas for some loan products, none of this dealt with the issues of the lack of service and lending in minority areas. With the DOJ investigation still ongoing, the FDIC could have recognized some improvement by the bank in upgrading its rating to Needs to Improve, which would have been clearly in line with the need to carry out more fully the remedies for its past discriminatory behavior. Instead, the FDIC granted the bank a full Satisfactory rating prior to the imposition of the remedies in the DOJ settlement.

Flagstar – Violating Your Way to an Outstanding Rating

If the regulatory agencies can't identify discrimination as blatant as that described in these examples of DOJ cases, then there is a fundamental problem that surely requires Congressional action to be corrected. Still, one might try to set aside these cases by claiming that these all involved settlements where the lenders claimed that they did no wrong. That is, these cases did not involve court decisions that fair lending violations occurred. Let us turn, then, to a case where there were such legal findings.

The case of Flagstar Bank, FSB, represents that rare exception where we actually have proof of fair lending violations that we can compare to the public comments of the institution's regulator and to the CRA ratings given to the bank before and after the violations occurred. This case illustrates how even multiple legal findings of discrimination can lead a lender to an Outstanding CRA rating.

- Between February of 1994 and November of 2005, during which time the OTS gave Flagstar Bank "Satisfactory" and "Outstanding" CRA ratings, this lender was sued several times in federal court for issues related to discrimination in lending. Flagstar, in contrast, was found liable for discrimination at trial or by the court in at least two of these cases.

- In 1999, a jury in Detroit found Flagstar liable for discrimination against minority borrowers, and plaintiffs were awarded damages. Later the Sixth Circuit Court of Appeals upheld one of these findings. In 2003, in a national class action suit, a federal court in Indianapolis found a written pricing policy developed by Flagstar management in 2001 so overtly discriminatory that the court ruled against Flagstar on summary judgment. The policy explicitly stated that pricing would be different for minority and non-minority borrowers. It appears that **the discriminatory pricing policy was developed and implemented by Flagstar *while* the OTS was conducting its consumer compliance examination**.

- The OTS conducted five CRA examinations and never found Flagstar in violation of discrimination laws. During this time period, Flagstar was given a

"Satisfactory" CRA rating four times and was elevated to an "Outstanding" rating **after** the summary judgment finding in 2003.

Flagstar was one of the nation's twenty largest mortgage lenders during the period covered by this litigation. It sold loans to both Fannie Mae and Freddie Mac and was one of the largest underwriters of FHA loans through certification granted by HUD.

Moreover, Flagstar was allowed to expand significantly during this time period by opening numerous branches, expanding into a new state, and expanding to additional metropolitan areas in these states. The approval of its applications to expand was based, in part, on its CRA ratings. As a result, during the period from 1994 through 2005, Flagstar grew from just over $500 million in assets to nearly $13 billion in assets.

The actions taken by Flagstar as a result of the settlement of suits in Detroit were actually used to raise its later CRA rating. After the Federal Court in Indiana forced the elimination of its written racial pricing policy, the OTS gave Flagstar an Outstanding rating, finding no violation of fair lending laws in spite of two legal decisions. *As bizarre as it seems, Flagstar seems to have literally violated its way to an Outstanding rating.*

For the regulators, their clever and narrow use of the regulations they drafted to control their own behavior allow them to treat these regulations as a kind of regulatory "signing statement" where they can use their own discretion to reinterpret or ignore lending behavior that would violate the fair lending laws.

<u>The Option of Including Affiliates in the CRA Assessment</u>

In the examination process, institutions are allowed to decide whether to include the loans from their holding company affiliates. This choice may radically change the lending patterns used in a CRA examination at the choice of the institution. Moreover, this may ignore the role of affiliates in other markets where their patterns may reflect discrimination. In addition, while the CRA examinations rely on previous fair lending examinations for evidence of discrimination, the fair lending examinations specifically instruct the examiners to "limit the inquiry to what can be learned in the institution and do not contact the affiliate" (at page 15).[8]

In cases where the institution is part of a holding company, the CRA regulations allow institutions to include or exclude the lending activities of affiliates of that holding company for any particular type of loan. Where an institution decides to include the

[8] These are the *Federal Reserve Consumer Compliance Handbook*, "Federal Fair Lending Regulations and Statutes – Examination Procedures" (updated to January 2006), and *Comptroller's Handbook – Consumer Compliance Examination*, "Fair Lending Examination Procedures" (updated to April 2006), and Office of Thrift Supervision, *Examination Handbook*, Section 1200 (updated to March 2007). In the interpretive introduction to the 1995 CRA regulations, the agencies also indicate how affiliates are not to be examined, stating that, "although lending by affiliates may be treated as lending by an institution, this treatment for CRA purposes will not permit a regulatory agency to examine any institution or its affiliate if it does not otherwise have such authority."

lending of the affiliates, all of the affiliate lending for that particular loan type are to be included in the examination.

Because Citigroup represents a large bank holding company with some extremely varied and complex affiliate structures, some of the problems with the treatment of affiliates by the regulators can be demonstrated in some examples from different depository institutions that are part of Citigroup. These examples highlight some key issues related to the treatment of affiliates as well as issues related to the CRA comment and challenge process, and issues related to the treatment of claims of discrimination and violations of other credit laws.

The first example is taken from the Comptroller's Public Evaluation of Citibank, NA in 2003. In the case of the evaluation of Citibank, NA, the institution chose to include all of the affiliate lenders of Citigroup in the CRA examination. The Comptroller lists seven affiliates where the HMDA data were combined with that of Citibank for the lending test. In this case, the Comptroller assigned an Outstanding rating for Citibank's lending test, guaranteeing it a passing CRA rating overall. In this example, we are not so much concerned about the actual rating as with the process used by the Comptroller.

The assessment area for Citibank is defined essentially as the New York City area and Long Island. In this case, even though Citigroup was the largest bank holding company in the United States and made loans all across the country through various "affiliates", the Comptroller's evaluation was based on the lending patterns in just a few counties in the state of New York (essentially New York City and Long Island). Indeed, the evaluation states that, "despite the fact that the affiliates are nationwide lenders, CRA consideration was only given for those loans made in the bank's AAs [assessment areas]" (at page 7). For any other lender with affiliates that made loans nationwide, the same standard would be applied.

One affiliate, Citicorp Mortgage, was one of the largest lenders in the nation, yet only its role as part of the aggregate pattern of all the affiliate lenders in the assessment area was reviewed. Moreover, "93.7% of the HMDA loans in the local assessment area were provided by the bank and the affiliate, Citicorp Mortgage" (at page 7). One issue, then, is that the dominant pattern for the lending test may be determined by a single affiliate. One can see as a practical matter that any institution's choice to include or exclude affiliates might radically change the lending pattern in a particular assessment area.

Another issue of concern is that the analysis of the lending patterns is generally done by reviewing the composite lending for the institution and all of the affiliates combined. If a holding company channels different loan products through different affiliates, as was the case with Citigroup and many holding companies, then any disparate racial patterns associated with the segmented lending may be hidden. Since the CRA rewards lenders for the level of loans, an apparent fair distribution of loans in the merged data may mask, for example, the channeling of prime loans to predominantly white and higher income areas and the channeling of FHA and subprime loans to minority and low- and moderate-income areas.

Another reason to use the example of Citibank is that it provides a view of how the Comptroller dealt with a specific past issue of challenges to the lending practices of an institution acquired by Citigroup. Generally, the CRA evaluations rely simply on the aggregate lending patterns of the institution and all affiliates combined. The Comptroller's evaluation is somewhat unique in this regard as it does comment on the separate impact of some of the subprime affiliate lending on the overall pattern as part of a special consideration related to recent CRA challenges and lawsuits against Citigroup in relation to the acquisition of The Associates, one of the nation's largest subprime lenders.

This evaluation covered a period from October of 2000 through June of 2003. This included the time right after Citigroup's acquisition of Associates First Capital Corporation, when a nationwide coalition of community groups mounted a CRA challenge based on the claimed discriminatory and predatory lending practices of The Associates (including such issues as packing credit life insurance into the loans). The challenge was denied and the acquisition took place. The Associates was generally merged into "CitiFinancial" affiliates.

Additionally, the Federal Trade Commission had sued Citigroup (as the successor parent company) for unfair and deceptive trade practices and violations of ECOA by The Associates. The initial settlement for that case was filed in February of 2003 and included a $215 million fund for restitution.

The "Fair Lending Review" section of the Comptroller's evaluation reads:

> We found no evidence of illegal discrimination or other credit practices. However, given the previous adverse publicity involving the bank's affiliates, including Citigroup's settlement with the FTC, the following comments are presented.
>
> With the acquisition of Associates First Capital Corporation in September 2000 and subsequent consolidation with Citifinancial, Citigroup has committed to resolve concerns that had been raised against the former Associates involving alleged deceptive and abusive lending practices.
>
> In considering any potential impact to our CRA assessment of Citibank, we acknowledge Citigroup's efforts to address individual customer concerns and the minimal impact that lending by the affiliate had to the overall lending in the bank's AAs. Therefore, although the concerns were considered, they did not significantly impact our CRA assessment of Citibank. (at page 11)[9]

[9] One may wonder about the scope of the evidence available to the Comptroller as a foundation for acknowledging "Citigroup's efforts to address individual customer concerns". Surely, some fundamental changes were made to the practices of The Associates when it was folded into CitiFinancial. One may note, however, that at the same time that the Comptroller was examining Citibank, the Federal Reserve was investigating CitiFinancial for continued misrepresentations in marketing credit insurance, for violations of

The comment on the "minimal impact" of the affiliate relates to sections of the lending test that report that two national subprime affiliates of Citigroup, CitiFinancial Mortgage Corporation (CFMC) and CitiFinancial, Inc. (CFI), were given a separate review. In accordance with the CRA examination procedures, this review only applied to the Citibank assessment area in the New York City area and Long Island. In the specific Citibank, NA assessment area, however, these lenders accounted for only "4.1% of the mortgage loans considered." The report concludes, "There was no difference at all in the bank's geographic distribution of home purchase and home improvement loans in low- and moderate-income geographies factoring CFMC and CFI loans."

While this does not cast doubt on Citibank's lending in its assessment area, this comment raises several issues about the CRA examination process. First, this indicates how the lending patterns for the CRA reviews only look at geographic distributions by area income and not race and ethnicity.

Second, the Comptroller specifically notes patterns for home purchase and home improvement loans while the major claims of potential racial bias in subprime lending at this time were focused on refinance loans, about which the Comptroller's report is silent. Third, by looking only at the role of the CitiFinancial lenders in Citibank's local assessment areas, the larger role of these subprime affiliates in other markets is ignored. Hypothetically, if there was discrimination in the lending of any of these affiliates in some other area, that would be ignored and a lender would be allowed to use the lending of these affiliates in its assessment area alone to boost its CRA rating.

For example, in 2002, the National Training and Information Center (NTIC) studied the distribution of prime and subprime loans between Citigroup's affiliates in 13 markets around the country from the 2000 HMDA data.[10] This study provides an example of how the role of subprime affiliates can vary from one market to another. In the New York City area, the market was for Brooklyn and Queens, where NTIC found that 11% of the loans were made by subprime affiliates. This was by far the lowest percentage of all the markets they studied. In Baltimore, 85% of the loans were made by the subprime affiliates. In Cleveland it was 93%. In Cincinnati, it was 94%. In Pittsburgh, it was 95%. In Syracuse it was 90%. Outside of the larger urban areas, the percentage of subprime loans was 94% in Des Moines, 96% in Wichita, and 96% in Central Illinois. This shows how one may get a very limited and unrepresentative view of the overall role of an institution's subprime affiliates when looking only at a single institution's assessment area in a CRA examination.

HOEPA, and for misrepresentations to the Federal Reserve investigators. In May of 2004, this investigation resulted in a Cease and Desist Order that included $70 million in civil money penalties.

[10] See NTIC, *Citigroup: Reinventing Redlining – An Analysis of Lending and Branch Disparities for Citigroup's Prime and Subprime Lending Affiliates*, June 2002. The percentages are taken from the summary table at page 13.

A fourth issue is whether the Comptroller's analysis actually does include all of the subprime affiliates. One affiliate which is missing from those listed by the Comptroller is Citicorp Trust, FSB (CTB). According to the CRA evaluation of CTB by the Office of Thrift Supervision (OTS) in May of 2004, this is a subsidiary of CitiFinancial Credit Company.[11]

Also according to the OTS evaluation, CTB works with another Citigroup company, Primerica Financial Services (PFS), to originate refinance loans. The OTS evaluation states:

> PFS representatives forward completed loan applications to CTB for review and approval. Nationally, there are nine loan processing offices, called $.M.A.R.T. (Save Money and Reduce Taxes) Solution Centers, that accept and process the applications. In addition, CTB has a facility in Hanover, Maryland that is responsible for the solicitation of the existing customer base for refinancing. None of these is considered a retail banking office. (at page 5)

The OTS evaluation further states that, "CTB originates first and second mortgage products primarily for debt consolidation purposes rather than refinancing purposes" (at page 5).

As a conceptual issue, debt consolidation refinance loans sold with the solicitation of other credit and insurance products and solicited for continual refinancing (flipping) are the types of loans that have been subject to the most concerns for discrimination and abuse. I know from my own experience working on suits against The Associates that at least prior to being acquired by Citigroup and becoming CitiFinancial, it continually ran marketing campaigns to flip existing loans in order to capture the remaining equity in the borrower's home, and in some cases simply to increase the interest rate and charge additional fees. Surely with this history, this should have been a major concern for the OTS.

If CBT had a depository institution in the New York City area with an assessment area overlapping with that of Citibank, NA, then one could understand that under the policy of not counting loans twice, these loans would be excluded from the affiliates included in the Citibank evaluation. The only assessment area defined for CTB, however, is for the Wilmington, Delaware, MSA. In this case, because CTB originates loans from many areas across the country, the OTS – a*t its own discretion* – selected 9 other metropolitan markets outside of CTB's assessment area for review as what it termed "Supplemental Evaluation Areas" to see if the lending patterns in these comparison areas reflected that same high level of service to low- and moderate-income areas as did the small share of CTB's loans in its actual assessment area.[12]

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[11] The OTS evaluation covers a lending period from 2001 to 2003. CitiFinancial Credit Company is also not listed as one of the affiliates in the Comptroller's evaluation of Citibank, NA.

[12] A list of these areas is found in Table 9 on page 15 of the OTS evaluation.

Therefore, by fiat, the OTS appears to have removed these large pools of subprime loans from the CRA evaluations of Citigroup depository lenders in any of the nine supplementary markets that it chose for comparison. Such a move is inconsistent with the CRA regulations and allows a regulatory agency to essentially hide the loans of an affiliate when they should be counted. In the New York City MSA, for example, the HMDA data for CBT indicates that it had 1,251 loans in 2002 and 1,162 loans in 2003.[13] Since CBT is part of CitiFinancial and a subprime lender, these loans should have been included in the Comptroller's evaluation of Citibank, NA.

This action by the OTS in regard to the loans of CBT is not restricted to the case of Citibank, NA. Citibank, FSB, one of the largest federal savings banks in the nation also received a public CRA evaluation in 2003 that reflected the exclusion of the CBT loans. In this case, the OTS defined 8 assessment areas for Citibank, FSB, across the country.[14] These included the Chicago MSA, the Baltimore MSA, two Florida MSAs, the San Antonio MSA in Texas, MSAs in Connecticut and New Jersey, and the Washington, D.C. MSA. The lending test covered loans for all of 2002 and through June of 2003. Citibank, FSB also chose to have the Citigroup affiliates included in its evaluation.

The OTS also recognized the issues related to the acquisition of The Associates and reported that the aggregate level of lending by the CitiFinancial affiliates across the combined assessment areas was quite small. For example, it stated that for the loans made in 2003 (the first half of the year) only "408 are from affiliates that offer sub-prime loan products" (at page 17). As with the Comptroller's evaluation of Citibank, NA, the list of affiliates did not include CTB, stating that "The only HMDA-reportable affiliate operating within Citibank FSB's assessment areas that is excluded is Citicorp Trust Bank, FSB, which is subject to its own CRA evaluation by OTS" (at page 16).

Based on the HMDA data for 2002, CTB made 4,274 loans in the six assessment areas for Citibank, FSB. Meanwhile, the OTS evaluation reported only 5,041 loans from subprime affiliates in the assessment areas for 2003. Including Citicorp Trust Bank loans would have increased the number of these subprime affiliate loans by 85%. In 2003, CTB made 5,181 loans in the six assessment areas. Counting just half the year would be 2,590 loans. Meanwhile, the OTS evaluation reported just 408 loans from all affiliates for the first half of 2003. Including the estimated half year of CBT loans would have increased the number of these Citifinancial related subprime loans by 635%. Put another

[13] In the data presented here and in the CRA evaluations, both the loans originated and the loans purchased by the institution are counted in the lending test.

[14] Office of Thrift Supervision, Community Reinvestment Act performance Evaluation – Public Disclosure – Citibank, Federal Savings Bank, September 8, 2003. The evaluation covered lending from January 1, 2002, through June 30, 2003.

way, the OTS report which considered the subprime lending of Citifinancial affiliates to be negligible in 2003 included just 14% of the actual number of these loans.[15]

There is also some question about the accuracy of the various Citifinancial loans that the OTS did include in its evaluation. My estimates of just loans originated by the Citifinancial affiliates used by the OTS indicates that there would have been 2,144 loans all of 2003. Half of this is 1,072. This is more than two and one half times the number used by the OTS.

Finally, the OTS review of Citicorp Trust Bank itself illustrates another issue with the way the CRA evaluations may work when the institution is primarily a subprime lender and no prime affiliates are included in the analysis. CTB received an Outstanding evaluation in the lending test because both in its lone assessment area and in the "Supplemental Evaluation Areas" hand picked by the OTS, CTB had higher levels of lending to low- and moderate-income areas than did the overall market (which includes both prime and subprime loans). Of course, we know from many studies and analyses of the HMDA data that subprime lending is more highly concentrated in lower-income areas and among lower-income borrowers. It is in these generally less sophisticated markets that the concerns over deceptive practices are greatest.

The CRA process simply gives high marks to a subprime lender for concentrating its loans in this lower-income segment of the market. This reveals just how shallow the lending test really is. While CRA examiners are prohibited from examining the actual loan practices of unregulated affiliates, they can, and should, carry out an examination of the marketing, underwriting, and servicing practices of the institutions they do regulate in the CRA process. Again, while we are not claiming any abuses by CTB in this statement, as a practical matter, high concentrations of subprime loans in these vulnerable markets could reflect either creative financial assistance or predatory and abusive lending. Regulators need to look at more than just the volume of loans to judge the meaning of high loan penetration rates in these lower-income (or minority) areas.

Therefore, from these examples, it is not clear that the regulators include all of the affiliates that should be included when an institution chooses this option. Moreover, a holding company can review the lending patterns of its affiliates and the areas covered by the assessment areas of its depository institutions and structure the choices concerning the inclusion of affiliates in ways that provide the most favorable lending picture for each institution subject to the CRA.

In summary, the CRA reviews in some cases hold institutions with a major national role in lending accountable only to a single, or a select few, local markets. Moreover, a lender may receive a passing CRA rating based on only some of the markets that it is supposed to serve while it is free to ignore the lending needs of other areas.

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[15] There might be some discrepancies between the exact geographic areas used for the HMDA data from the selected MSAs and the assessment areas. The data for 2003 represents just half of the 2003 data because there is no way of actually calculating from the HMDA data which loans were originated or purchased in the first half of 2003.

Regulators allow lenders to pick the affiliates to be included in a CRA review and regulators even choose to exclude affiliates even when the lender chooses to include them.

Ignoring the Negative Impacts of Lending:

The regulatory agencies charged with enforcement of the CRA have been issuing guidance and warnings about predatory lending since the late 1990s. In 2000, HUD and Treasury jointly issued a report on the abuses of predatory lending, the growth of the subprime market where predatory practices are most common, and on the dire impact of subprime foreclosures on communities – largely minority communities.[16] Yet, as is shown in the examples above, the regulators gave high ratings to lenders that had concentrated subprime lending in low- and moderate-income communities.

Just last week, Comptroller Dugan testified before the Financial Crisis Inquiry Commission that in the peak years of subprime lending (2005-2007) nationals banks "originated" just 10.6% of the subprime loans.[17] In Appendix B to his statement, however, Comptroller Dugan himself presents other studies that indicate that his figures are based on a very limited view that only includes loans with selected features that were originated directly by a national bank itself. It ignores the loans made by other affiliates of that same bank's holding company. Using the definition of "high cost" loans from the Home Mortgage Disclosure Act, the Comptroller cites other figures that include all affiliates that indicate that 54% of the subprime loans in 2006 and 79.6% of the subprime loans originated in 2007 were originated by institution subject to federal regulators.[18]

Howevr4 one counts these loans, what has been generally ignored until the work of the Financial Crisis Inquiry Commission is that the lines of credit used by the independent mortgage companies (such as warehouse loans used to originate loans and store them prior to sale or securitization) come from commercial lines of credit such as those from the largest national banks. Again, in his statement before this Commission last week, Comptroller Dugan (even using his own carefully parsed definitions) indicated that national banks provided at least $33 billion in warehouse lines of credit to subprime lenders.[19]

Therefore, while the national banks may not have made the majority of subprime loans directly, they provided the funds to the lenders that did originate the loans. In

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[16] U.S. Department of Housing and Urban Development and U.S. Department of the Treasury, *Curbing Predatory Home Mortgage Lending: A Joint Report*, (June 20, 2000).

[17] Comptroller John C. Dugan, written statement submitted to the Financial Crisis Inquiry Commission, April 8, 2010, at page 8. [http://fcic.gov/hearings/04-08-2010.php]

[18] Comptroller John C. Dugan, written statement submitted to the Financial Crisis Inquiry Commission, April 8, 2010, Appendix B, at page 5.

[19] Comptroller John C. Dugan, written statement submitted to the Financial Crisis Inquiry Commission, April 8, 2010, at page 10.

addition, the national banks participated in the securitization of the pools of loans made from the bank lines of credit. In this way, the national banks provided support for the entire subprime industry at both the front and back end of the process. Without this support, the industry could not have gown to the scale where it caused the meltdown of the financial markets.

In addition lenders making loans against the future pay of borrowers (payday lenders) and lenders making loans against a person's vehicle title (title loans) have been major actors exploiting people with financial difficulties. Again, the regulators have shown a clear awareness of the abusive practices of payday lenders. The Comptroller, for example, issued an Advisory Letter (AL 2000-10) in November of 2000 warning lenders of the high risk and abusive nature of these loans.

Nonetheless, as indicated in a recent report by the Center for Responsible Lending, some of the largest mainstream banks are making high interest loans (based on the fees for the loans) against the future paychecks of the account holders.[20] In addition to these direct "payday" loans, the NPA "Payday Lender Financing Factsheet" I am submitting with my testimony shows how the large national banks are funding the payday lenders with lines of credit and other financial resources. For example, the factsheet indicates that Wells Fargo is involved in funding approximately 30% of the payday industry (based on the payday store locations).

I have never seen a single CRA public examination report that has penalized a national bank for disproportionately concentrating subprime loans in minority or low- and moderate-income areas. In addition, I have never seen a CRA examination report that even indicates that the Comptroller has reviewed a bank's provision of lines of credit to the subprime or payday lending industry or that the Comptroller has examined the bank's role in the securitization of toxic loans.

These oversights indicate that even within the current scope of the CRA, the regulators have developed such a narrow focus on granting positive credit for a few consumer loan products that the largest banks can either directly or indirectly support the most toxic lending products without any concern for how it might affect their CRA ratings.

The "Sunstroke" Legislation

In addition to issues related directly to the CRA examination process, the "sunshine" provisions of the Gramm-Leach-Bliley Act of 1999 allow the regulatory agencies at their pure discretion to impose arbitrary and extreme punishments on community groups and citizens who dare to comment on a lender's performance and engage in reinvestment agreements. Yet, no obligations are placed on the performance of lenders in such agreements. This Congressionally approved intimidation of American citizens has produced, as the banking lobby had hoped, a chilling effect on community involvement in the CRA.

[20] Center for Responsible Lending, "Mainstream Banks Making Payday Loans", February 2010.

The Community Reinvestment Act was designed to protect minority and low-and moderate-income communities from redlining and disinvestment and to create the basis for a development banking industry for underserved communities in the United States. Community-based organizations have done their work.

With few resources and sheer determination, these organizations have led the way in identifying underserved markets, proposing real business solutions, and developing the public-private partnerships to provide the structural and institutional support to channel needed reinvestment into rural, small town, urban, and minority communities. The community-based organizations often created structures or institutional vehicles to channel investments into economic development and housing rehabilitation and development activities when they did not already exist.

Since the CRA was implemented, community-based organizations have been responsible for the creation of hundreds of Community Reinvestment Act agreements and programs. I have been involved personally in projects that have reviewed hundreds of Community Reinvestment Act agreements and programs. These agreements have resulted in well over 100 billion dollars of reinvestment in once redlined and ignored communities.

Aside from the model of South Shore Bank (now called Shorebank), virtually all of the most significant, most effective, and most creative reinvestment programs have their source in models that came from Community Reinvestment Act agreements. These include state-wide or local activities across the country in most of the districts or states represented by this Committee.

These agreements are not defined in the Community Reinvestment Act itself. They arose as part of the assessment of community credit needs and the active participation of the communities that the CRA was designed to serve. Often they evolved from the failure of the lending institutions to take active steps to comply with the CRA and the failure of the regulatory agencies to enforce the Act. Since there is no right to private action under the CRA, community groups and citizens working with a broad range of development organizations not only defined their credit needs but built the programs and capacity to meet those credit needs through the models provided by these formal CRA agreements. The agreements often arose from comments placed in the CRA file, from direct contacts and negotiations with lenders, and from challenges and testimony at CRA hearings on banking applications.

The so-called "CRA Sunshine Requirements (§711) of the 1999 Gramm-Leach-Bliley Act, represent the most reprehensible use of Congress with the banking lobby and the regulators to squash this history of citizen participation in the Community Reinvestment Act.[21] On the surface, this section of the Act may appear to recognize these agreements in requiring public disclosure of their contents, terms, and conditions.

[21] The CRA Sunshine Requirements are amendments that add a Section 48 to the Federal Deposit Insurance Act (12 USC 1811 et seq.). References in this statement are to Section 48.

It might also appear on the surface that the Act brings some accountability to these agreements by requiring some disclosure by both the depository institutions (or any "affiliate" of the depository institution) and "each nongovernmental entity and person" that is a party to the agreement. In fact, the law is a bizarre form of intimidation designed to terrify community groups and individuals from making such agreements - or even from filing comments or making any contacts related to community credit needs and the CRA.

A CRA agreement is defined as any contract between "a depository institution or affiliate" and "a nongovernmental entity or person made pursuant to or in connection with the Community Reinvestment Act of 1977" (§48(a)). Essentially, any "nongovernmental entity or person" (indicated as an NGEP in the implementing regulations of the regulatory agencies) that has a "CRA communication" with the depository institution and then has a formal agreement with that institution is subject to the provisions of the sunshine requirements and enforcement actions. The implementing regulations for the Federal Reserve provide an example of the "CRA communications" that would subject an NGEP to the law:

> (a) *Definition of CRA communication.* A CRA communication is any of the following—
>
> > (1) Any written or oral comment or testimony provided to a Federal banking agency concerning the adequacy of the performance under the CRA of the insured depository institution, any affiliated insured depository institution, or any CRA affiliate.
> > (2) Any written comment submitted to the insured depository institution that discusses the adequacy of the performance under the CRA of the institution and must be included in the institution's CRA public file.
> > (3) Any discussion or other contact with the insured depository institution or any affiliate about—
> > (i) Providing (or refraining from providing) written or oral comments or testimony to any Federal banking agency concerning the adequacy of the performance under the CRA of the insured depository institution, any affiliated insured depository institution, or any CRA affiliate;
> > (ii) Providing (or refraining from providing) written comments to the insured depository institution that concern the adequacy of the institution's performance under the CRA and must be included in the institution's CRA public file; or
> > (iii) The adequacy of the performance under the CRA of the insured depository institution, any affiliated insured depository institution, or any CRA affiliate (12 CFR §207.2(b)).

Thus, virtually any person or organization that made a comment about its community credit needs, commented on or testified about the lender's past performance, or suggested a form of reinvestment could be subject to the law. As the implementing regulations of the Federal Reserve indicate, such an organization or person could be subject to all the disclosures and penalties of the sunshine requirements, even if the organization or person never actually signed an agreement with the institution. As an example of a covered agreement, the Federal Reserve regulations indicate that if a NGEP simply had a meeting with the lender and defined the specifics of a program and the lender later made a press release that reflected these conditions, this would be considered an agreement subject to the law (12 CFR §207.3(a)).

While depository institutions are required to provide only general data on the annual amounts of resources allocated to an agreement, the community organizations and individual parties are required to file detailed financial accountings of how each dollar that it received was spent (§48(c)).

The federal regulatory agencies may take the disclosure data and determine at their discretion that the community and any individual citizens who are party to the agreement have not fully complied with the disclosure laws. In this case, the regulatory agency is empowered by Federal law to declare the agreement "unenforceable".[22] Even more threatening, the regulatory agency may decide through its own interpretation of the agreement that the funds were not used properly by the community organizations or any individual citizens party to the agreement. In this case, the agency:

> May impose either or both of the following penalties:
> (i) Disgorgement by the offending individual of funds received under the agreement.
> (ii) Prohibition of the offending individual from being a party to any agreement described in subsection (a) for a period of not to exceed 10 years. (12 USC 1831 §48(f).

On the other hand, *there are no penalties defined in the law for a depository institution (or an affiliate) that violates the agreement in any way*. Indeed, the law specifically states that "no provision of this section shall be construed as authorizing any appropriate Federal banking agency to enforce the provisions of any agreement described" in the law (12 USC 1831 §48(g)).

This law has a chilling effect on any organization or person who would want to file CRA comments or participate in a challenge. If that organization or person later proposed a reinvestment program for that institution and the institution adopted the basic components of the program, these organizations and persons would be subject to the burdens and penalties of the so-called sunshine provisions while there are no penalties for the lender if it disregards its obligations in the agreement. Nothing is more contrary to the original intent of the CRA.

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[22] The right of the regulatory agencies to void a reinvestment agreement stands in contrast to their statements concerning CRA agreements in the interpretive comments preceding the 1995 regulations. In those comments, the agencies state, "The CRA requires the agencies to assess an institution's record of helping to meet the credit needs of its community, not to enforce privately negotiated agreements. Therefore, an institution's record of fulfilling these types of agreements is not an appropriate CRA performance criterion."

The Sounds of Silence

Since the implementation of the Gramm-Leach-Bliley sunshine provisions, only a handful of brave organizations in Cleveland, Massachusetts and a few other places have filed protests and comments on applications. For example, this Subcommittee requested and received from the Comptroller a list of all merger applications from 2000 to the present. The list includes several hundred applications. The applications involve many of the major institutions that have been the subject of protests in the past, yet the Comptroller has indicated that there has not been a single comment filed against these applications.

The Ugly

As the financial markets sank rapidly into the stormy sea of deregulation, ultra free market advocates looking for a scapegoat have resurrected their claim that the Community Reinvestment Act is to blame for the mortgage meltdown – and the entire world financial crisis. In particular, they claim that the revision of the CRA regulations in 1995 forced lenders to make risky loans to unworthy borrowers in order to serve an essentially minority market. They claim the regulators threatened banks with huge penalties and forced them to invest in subprime loans. The campaign to blame the meltdown on the Community Reinvestment Act and on lending to lower-income and minority borrowers is a perversion that stands reality on its head. The background in the previous sections of my statement provides the context to set the record straight.

Back in the 1960s when our country was famously described as "moving toward two societies, one black, one white – separate and unequal", the federal government simply ignored the racial discrimination by banks that led to the wholesale denial of lending to minorities and in communities of color. At the same time, HUD responded to its historical role in supporting the racial redlining of minority areas by virtually eliminating sound underwriting, ignoring the need for oversight of its lenders, and then flooding minority markets with FHA loans.

The predictable result was a massive exploitation of the underserved minority markets through fraud and deceptive lending practices and the combined efforts of real estate agents and FHA lenders who used FHA lending to foment racial change and racial fears and re-segregate communities for profit. Unsound and fraudulent loans produced massive levels of foreclosures and the rapid spread of blight destroyed whole segments of cities such as Detroit, Chicago, Baltimore, Cleveland, and Philadelphia.

With no response from the government, community groups from across the country formed the National People's Action and forged a multiracial, urban and rural coalition that arose from the neighborhoods of Chicago and spread across the country. NPA's fundamental focus was on discrimination in the real estate and lending industries. The Community Reinvestment Act was NPA's great achievement. For community organizations across the country it is both symbolically and practically the litmus test of any claim of financial industry reform.

Rejecting the option of financial welfare, the CRA was simply a requirement that for the benefit of taxpayer-backed deposit insurance (and, today, the bailout slush funds) the banking industry owes it to the American people to seek ways of investing and lending creatively, but soundly, in all communities. It was not a demand to loan to lower-income persons and minorities regardless of their financial situations. It was a call on the financial markets to use the creativity, ingenuity and the resources of the free market system for fair lending and to build a development banking industry in our country as a basis for the reinvestment in communities that had been discriminated against or that lagged behind new growth areas where the money flowed so freely.

When the banking industry and regulators fought against the CRA and its simple requirements, the community groups that had created it took on the responsibility for defining their own financial needs, acquiring their own skills, and forging partnerships with lenders, investors, and insurance companies for housing and business programs. For more than 30 years since the CRA has been in effect, community groups have led the way to reinvestment. They even created support services and local development organizations where these were needed. Over the years, trillions of dollars have been reinvested in inner-city communities and smaller cities and towns bringing new life to once abandoned streets and neighborhoods.

The reinvestment programs created sound products. Loan programs were specifically developed to account for the needs and situations of low- and moderate-income borrowers who were typically unfamiliar with credit markets. Counseling programs and careful monitoring of programs produced portfolios that often outperformed the larger mainstream credit markets. In its own study of CRA program loans, the Federal Reserve noted that the median loss rate on these reinvestment programs was exactly zero.[23] According to a report issued by the Federal Reserve Board of Dallas last year "…data…suggest that the CRA prevented the subprime situation from being more severe."[24]

Even Comptroller Dugan noted the outstanding performance of CRA lending in a speech back in 2008 when the "Blame CRA" theme emerged to explain the meltdown. He noted:

> Overwhelmingly, this lending has been safe and sound. For example, single family CRA-related mortgages offered in conjunction with NeighborWorks organizations have performed on a par with standard conventional mortgages.4 Foreclosure rates within the NeighborWorks network were just 0.21 percent in the

[23] *The Performance and Profitability of CRA-Related Lending Report by the Board of Governors of the Federal Reserve System*, Submitted to the Congress pursuant to section 713 of the Gramm-Leach-Bliley Act of 1999, July 17, 2000, page 70.

[24] Federal Reserve Bank of Dallas, "The CRA and Subprime Lending: Discerning the Difference" Banking and Community Perspectives, Issue 1, 2009.

second quarter of this year, compared to 4.26 percent of subprime loans and 0.61 percent for conventional conforming mortgages.[25]

Contrary to the claims of those blaming the CRA for the meltdown, the 1995 revisions of the CRA regulations weakened rather than strengthened the CRA. Nonetheless, the regulators made a point of emphasizing in the preface to the 1995 regulations that nothing in the regulations sanctioned risky loans and that no specific loan standards, ratios or measures would apply to any lender. In spite of this statement and in spite of the warnings that the regulatory agencies put out in the form of "guidance" on predatory loans, the regulators, the GSEs, HUD, naive economic researchers, and those trying to blame the CRA for the meltdown engaged in a bit of definitional slight of hand and defined all loans made in low- and moderate-income census tracts as a CRA loans. Thus, they counted every predatory loan pumped into these communities as a CRA loan in spite of the unceasing objections of the community groups, consumer groups, and civil rights groups that had been working on sound reinvestment for decades. This created evaluations the were based on the extraordinarily absurd position that concentrations of subprime loans, often to the exclusion of sound prime loans, in lower-income and middle income neighborhoods were to be rewarded with high grades for reinvestment under the CRA or for credit in meetings the GSEs housing goals.

As I have shown, in some cases, regulators even gave high CRA ratings to lenders found liable in Federal court for racial discrimination or to major lenders that explicitly cut out of their lending areas, for example, the entire City of Detroit or the minority sections of Gary, Indiana, or Chicago. In this regard, the banking regulators literally encouraged subprime discrimination by abandoning these communities to the subprime market. At the wholesale level, the regulators failed to monitor the risks on the credit lines from the major banks to the subprime mortgage lenders that gave the lenders the cash flow necessary to warehouse their loans for sale in the securities markets.

For its part, it is true that Fannie Mae again drove one of the engines that encouraged subprime discrimination and exploitation. While it had been prodded by community and consumer groups to refuse to purchase individual mortgages with certain abusive subprime characteristics at its front door, it became one of the largest purchasers of these same questionable subprime loans through its own investment in mortgage-backed securities at the back door. Its purchases in recent years were as large as one quarter to one third of the subprime securities issuances. This must go down as one of the most extreme examples of corporate hypocrisy on record – not to mention the betrayal of its affordable and fair housing obligations.

The people who created the CRA in response to the abusive and exploitive FHA lending practices of the 1970s were not stupid. They would not choose toxic loan products over sound products when they had the choice. For their part, the community organizations that had been working on reinvestment for over twenty years, warned

[25] Comptroller John C. Dugan, speech before the Enterprise Annual Network Conference, November 19, 2008.

Washington of the coming nightmare as abusive lending progressed into massive foreclosures. While the media now praises as great prophets the economists and regulators who saw the meltdown coming as early as 2005, it was the community groups in the 1990s who first suffered the scars of a new wave of foreclosures and saw in it the resurrection of massive lending scandals.

By 1995, community-based organizations had begun studies of the impacts of concentrated and abusive subprime lending that resulted in parallel concentrations of foreclosures accompanied by declining housing values and rising tides of blight and crime. Research and reports from the National Training and Information Center, the Center for Community Change, The National Community Reinvestment Coalition, the Center for Responsible Lending, the Consumer Federation of America, and host of other community, civil rights, and consumer groups have continually warned of the coming subprime disaster for over a decade. In 2000, HUD and Treasury built their own reports (*Curbing Predatory Lending* and *The Unequal Burden*) on the models of the community research and documented the alarming increase in subprime lending, unfair and deceptive practices, and the growing concentrations of foreclosures, particularly in inner-city and minority communities. Ironically, the government did not even heed its own dire warnings.

By 1999, community groups were challenging merger and acquisition applications involving subprime lenders and were challenging the regulators not to count subprime lending for CRA credit. Through a national level coalition in 1999, community-based organizations and consumer and civil rights organizations came together to challenge the acquisition of one of the largest and most notorious subprime lenders (The Associates) by Citigroup. The many documents they produced foretold of the abusive subprime practices that would eventually undermine the entire financial world. Their challenge was brushed aside and the regulatory agencies continued to ignore the gathering storm.

When Fannie Mae and Freddie Mac dove into subprime investments, it was the community groups that had created the original, and sound, GSE community lending programs that attacked this behavior. They challenged HUD not to count subprime loans as part of the GSEs housing goals.

The communities that should have been protected from abusive lending by the regulators were, instead, victimized by misleading and deceitful marketing practices designed to create credit needs and sell toxic loans. The growth of fraudulent and abusive marketing within the larger subprime market was explicitly identified in the HUD and Treasury reports. In the same year as these reports, a trial in Federal court in Philadelphia against The Associates, the largest subprime lender at that time, revealed a broad range of deceptive marketing practices and programs. One program was designed specifically to flip (refinance) existing loans purely to raise the interest rates and generate more lender fees. Another program actually tested the loan offices to make sure that when they folded fees and unnecessary credit insurance into the loan proposals they *did not* disclose this to the borrowers. Major lawsuits claiming deceptive and misleading trade practices were filed by the Federal Trade Commission or the attorneys general in states all across the country against the very largest subprime lenders (The Associates, Household Finance, Ameriquest, and Countrywide), resulting in settlements of several billion dollars. At the same time, data from Treasury indicate that reports of lending fraud in the mortgage markets (largely related to brokers and appraisers) have increased thirty-fold since 1997.[26]

Meanwhile, it was the community-based organizations and the understaffed and under funded legal assistance attorneys that developed successful interventions. By challenging fraudulent or abusive underwriting and servicing practices, these groups have been able to restructure and rescue as many as 80% of the homeowners who came to them in need - a testament to both the effectiveness of the program and the level of abusive practices in the subprime markets. While restructuring may result in some write down on the loan initially, it produces a performing loan that, in the long run, stabilizes the loan and, when done on a large scale, can stabilize the mortgage-backed securities. Indeed, the present mortgage rescue legislation is finally turning ever so reluctantly and slowly to this reality.

One of the most effective rescue programs was used by a community group in Cleveland in the Zip code with the highest number of foreclosures nationally. But while the program has proven how effective a rescue program can be, it lacked the resources to reach the scale needed to stave off the crisis either in the Cleveland market or in other communities. The community programs worked on a loan-by-loan basis with lenders and servicers through agreements made after community groups exposed their abuses to the public – but this model could never meet the full scale of the problems. Even though a few lenders account for the vast majority of the foreclosures, the legal aid programs that receive government funding also work on a loan-by-loan basis, as a Reagan era attack on legal aid for the poor still prohibits them from filing class actions.

In the end, long before the housing bubble burst and brought the pain of subprime foreclosure to the upper-middle class and high income markets, the abuses in the subprime markets had already destroyed many communities that responsible community groups had spent decades rebuilding. When the flood of foreclosures began a decade ago, the physical impact of the foreclosures was like Katrina without the water. Whole blocks of homes were boarded, abandoned, or burned. Yet, no Anderson Cooper stood in the streets of these decimated neighborhoods "keeping them honest" by exposing the government's failure to protect its citizens. No cry was raised at the failure of the government watchdogs to rescue these neighborhoods. Yet, these minority, working class, and small town communities were just as much abandoned by Washington as were the residents of New Orleans. It was the Federal Reserve Board, the Comptroller of the Currency, the Office of Thrift Supervision, the Federal Deposit Insurance Corporation, HUD, the Department of Justice, Congress, and the Administration, individually and collectively, that failed to protect our citizens from the subprime tsunami.

[26] Financial Crimes Enforcement Network, U.S, Department of Treasury, *An Update of Trends Based Upon an Analysis of Suspicious Activity Reports*, April 2008, page 21.

There is no question that the subprime debacle has contributed to a real need to intervene to ward off a crisis in the global financial markets. Everyone recognizes the need to secure the credit markets. But the organizations that represent the communities that have already paid twice for the failure of the government to protect them from fraud and lending abuses on a massive scale want to know why it is possible to develop interventions costing hundreds of billions of dollars for Bear Sterns, Fannie Mae, Freddie Mac, AIG, and now the entire lending and investment market within a few days while the homeowners who were victimized by the lending abuses were abandoned year after year. Why, they ask, are these financial institutions too big to fail while the collected millions of homeowners American communities are not.

Those who have taken on the responsibility for the rebuilding of their communities when they were forsaken by their government decades ago; those who have kept up the fight in spite of being betrayed by their government's wholesale support of the subprime market's exotic and toxic behavior in the last decade; these citizens are mightily offended that anyone would blame them for the financial crisis.

Underpinning the Blame the CRA Campaign is the assumption that lower-income persons - and especially minorities - are so financially untrustworthy and such a high lending risk that making loans to these Americans has pushed the entire global economy to the brink of collapse. This is an exceptionally scantily veiled form of racism. To lay blame on the minority markets whose representatives have been sending out warnings for over a decade is to blame the canaries in the mine for the explosion.

Key Elements of a Meaningful Modernization of the CRA

Where Are We Now?

The regulatory agencies and the CRA "sunshine" requirements have twisted the CRA by:

(1) removing the obligation of depository institutions to define a local service in a way that eliminates racial redlining;
(2) removing the separate assessment of discriminatory actions from the formal rating process and;
(3) failing to develop and implement a sound fair lending examination process that includes both the subsidiaries and affiliates of a covered institution;
(4) relegating compliance with the fair lending laws to an undefined appendage of the rating process subject to the pure discretion of the regulatory agencies such that institutions can receive Outstanding CRA ratings while they violate the fair lending laws;
(5) removing the review of the institution's assessment of local credit needs from the evaluation process;
(6) removing the assessment of the institution's efforts to communicate with its community in defining credit needs;

(7) threatening community organizations and individuals who dare to comment on credit needs and who develop reinvestment programs;
(8) granting an institution a passing CRA rating if they have an Outstanding rating in the lending test (even if the lending area redlines minority communities);
(9) making challenges futile by granting an institution with a passing CRA rating a presumptive bias in favor of approving applications; and
(10) failing to regularly hold hearings when an application is challenged.

In response to this historical context, we offer our comments on key elements that need to be incorporated into a modernization of the CRA

1. Expand Disclosure

If no other provisions existed to provide for an expansion and update of the Community Reinvestment Act, provisions for increased disclosure must be made. CRA has resulted in trillions of dollars of successful reinvestment and in almost every case these investments were the result of a vigilant public and community that challenged a financial institution to do better. The community cannot do its job without access to usable data. In the housing markets, and to a much lesser extent in small business lending markets, Home Mortgage Disclosure Act data and Community Reinvestment Act data have been the key resource in identifying underserved markets, for defining credit needs, for identifying fair lending issues, for developing reinvestment programs and models, and for monitoring the results of reinvestment initiatives.

Home Mortgage Disclosure Act Data:

Increased disclosure is required to advance the goals of the fair lending laws and the Community Reinvestment Act. **HMDA data need to include a wider range of data on loan products, loan terms, borrower credit profiles, fees, interest rates, and sourcing (brokers, wholesale, retail, correspondent).**

The failure to include loan performance and servicing (default and foreclosure) data blocked both public agencies and the communities from identifying the impacts of the subprime lending markets before they had destroyed entire communities and wiped out billions of dollars in past reinvestment. We might well have avoided much of the mortgage meltdown had we had access to loan performance data – even in the all too limited way it has been required for FHA loans for almost 20 years.

Expanded Business, Insurance, and Investment Disclosure Data:

The extremely limited form of business lending has hampered efforts to expand commercial economic development efforts in lagging local markets all across the country. With the current Great Recession, the need for a development banking industry is greater than ever and encompasses a need much greater than the prior CRA focus on low- and moderate-income communities alone. The Community Reinvestment Act is essentially the only comprehensive resource for economic development in lagging local markets in the United States. Yet, there is almost no development banking industry in commercial lending in America because development banking has been developed around the creative efforts of community and development organizations rather than being initiated by the banking industry. Where the HMDA data created hundreds of reinvestment programs in housing, an expanded public disclosure of business lending could do the same for commercial development.

Moreover, **as the full range of financial products come under review for both their positive and negative impacts on economic growth and stability, disclosure needs to encompass this range of loans as well as providing data on insurance and securities products.**

Disclosure of Existing Program Monitoring Data:

Additionally, there are a host of new, existing and proposed programs that aim to strengthen bank performance, fix the fall-out from the mortgage crisis, and mitigate the effects of the economic collapse and all of these initiatives will and/or should produce performance data. It is imperative that these data not fall into a black hole but be brought to light where they can inform monitoring and improvements in these programs.

Data from the Home Affordable Modification Program (HAMP – generally know as the Making Home Affordable Program) provides a good example of how fair lending issues are kept out of the public form. Presently, Treasury maintains that it cannot provide any form of the HAMP data that links individual servicers to data on race or gender, or even to census tracts. This is based on a claim that such government monitoring data is not "performance data" for the program and that the Servicer Participation Agreements with the servicers in the program prohibit the publication of anything but "performance" data linked to individual servicers. Of course, since servicing is clearly covered by the Equal Credit Opportunity Act, then performance data should include information related to compliance with civil rights laws.

Disclosure of Examination Results:

Finally, in a different form of disclosure, in order for any newly proposed lending and service tests to be effective, **community groups and the public at large must have access to lending test results** to discern the players and their impact on local neighborhoods. These results should be published in a usable format for all regulated banks, their servicers, subsidiaries, and affiliates.

2. Fair Lending and Access

Background:

Probably the greatest weakness in the current CRA is the omission of a focus on fair access to financial services (including depository services) and an assessment of discriminatory practices. As I have noted in the review of the historical context of the CRA, the original CRA was passed with the assurance that fair lending laws were so clearly understood as being a part of the CRA that no direct fair lending provisions needed to be added to the CRA itself. The history of the increasing omission of fair lending and fair access to financial products and services in the examination and rating process and regulations has shown that the CRA must be amended to specifically prohibit discrimination in all forms and to include requirements for fair access to all financial products. Moreover, as indicated in the section below on accountability, **whatever else may come from the CRA modernization, it should ensure that violations of the fair lending and fair housing laws by any entity within a holding company will result in the failure of the entire holding company and all of its affiliates.**

As an historical pattern, the abusive uses of financial products has typically first manifested its impacts in minority markets and minority and racially diverse communities. From the fraud and abuses in the FHA programs in the 1970s to the toxic subprime markets of the present meltdown, minority markets have been the canaries in the mine that have provided the warnings (though unheeded) of the coming disasters in the market.

A clear focus on fair lending and fair access to sound and beneficial financial products not only makes it clear that a violation of the civil rights laws is a violation of the CRA, but it would have the practical effect of making the regulators and public pay attention to the warning signs of fraud, deception, and potentially toxic products in the markets. Had the regulators paid attention to the fair lending concerns (and many studies and reports) of the community-based and public interest groups (going back well over a decade) about the impacts of the subprime lending markets, we would have mitigated much of the present financial crisis.

<u>Required Provisions:</u>

All activities of all holding company entities need to be specifically covered for review for fair lending compliance, which must include loans made, purchased and securitized. Parallel requirements must apply to other financial services, such as insurance.

Wherever and however community service areas are defined, these areas must be assessed for the exclusion of minority areas as well as the traditional exclusion of low- and moderate-income areas. (We support the general concept of the 5% of the market standard contained in HR 1479.) This assessment must include a review of actual lending and service patterns as well as the communities defined as service areas in the Act or by the institution. This must also include an analysis based on the disparate concentrations of both sound and toxic products. All significant disparities need to be investigated and where there is cause to find disparate impacts or treatment, the entire holding company must be given a failing CRA rating and be required to engage in corrective action.

In addition, the review of discrimination must include all the protected categories under ECOA and the Fair Housing Act. For example, it must include assessing whether loans (or the purchasing or securitization of loans) are made to properties that fail to comply with accessibility standards or whether they exclude properties designed to serve protected classes.

3. Accountability

Beyond the expansion of the CRA beyond additional disclosure and fair access to financial products, the law is sorely in need of provisions to establish real accountability. Establishing accountability involves a least the following key types of provisions in the Act:

Coverage for Assessments and Ratings:

The Act needs to cover all entities of a holding company. Moreover, it is not enough to cover each entity individually, as is the main focus of the current bill. It is important to require an overall assessment of the entire holding company as well as an assessment of individual entities or functions.

Within this process, all of the lending (purchasing and securitization) activities of the holding company entities must be reviewed as a single function with an overall rating so that disparate patterns for different subsidiaries and channels are assessed in the context of the entire lending activity of the holding company. For example, unlike the current practice, fair lending examinations must necessarily include all of the holding companies that made (or purchased or securitized) loans in a single assessment so that any disparate patterns or dual patterns based on the different lending entities or sources are included in the assessment. While these recommendations will provide for a serious consideration of fair lending within the institutions and areas covered by the CRA and its examinations, these measures can only be effective if the fair lending examination process, itself, includes all affiliates, is subject to a regular schedule for all lenders, and results from clear revisions in the process to eliminate the failure to adequately cover such areas as marketing, steering, underwriting, and pricing.

In making reviews of lending and investments, the regulators must review both the direct consumer lending of the institution's holding company affiliates and the larger commercial lending activities that support other direct lending markets, such as warehouse lines for independent mortgage companies or lines of credit to payday lenders. Moreover, a review also needs to be made of the securities issued by the holding company affiliates and the securities purchased by the holding company affiliates. It is pointless, and even harmful to the community, to rate an institution only on the direct loans it makes while ignoring the larger impacts of the investments packaged into the securities it issues or purchases. In the subprime example, a lender may have made some loans through a CRA program while that activity is dwarfed by the holding company's purchase of toxic loans that undermine the stability of the same type of community.

Civil rights (fair lending) violations (including the review of the communities served) must result in the overall failure rating for the entire holding company. Evidence of discrimination by any affiliate or subsidiary of a holding company – or as a result of an overall (composite) lending or investment pattern or practice in any location in the United States - should be counted as evidence of discrimination that should require an automatic rating of Needs to Improve or worse for all CRA covered institutions within the holding company where evidence of discrimination is found. In this way, there would be some pressure put on the non-banking subsidiaries that are not likely to have "covered applications" by putting a hold on applications from those banking entities most likely to apply for banking privileges.

A Clear Plan as a Base for Assessment:

Presently, there is no clear base from which assessments are made. When the Act was first implemented, lenders were required to define local assessment areas, define the credit needs of these areas, and list the products they would provide to meet these needs. Rather than require a plan for institutions that have a failing rating based on the present amorphous standards, **the CRA should require a plan at the beginning as a base for the assessments.** Then, assessments must be made in relation to the plan (or the plan as revised subject to challenge as noted below).

Plans should recognize the different capacities and roles of different institutions and holding companies and provide for plans based on the capacities and resources of each holding company. The plans need to apply both to the holding company overall and to each individual entity. This allows each holding company, and each subsidiary, to define a role according to its own business plan and strategy. In effect, since all such entities will already have a business and marketing plan, the CRA plan simply ensures that the operating plans of the entities have a focus on and a logical link to the needs of Main Street as well as the larger investment markets.

The assessment of lending, investment and service patterns needs to account for the negative as well as positive impacts of the products provided. We recognize that the regulatory agencies have shown lack of concern for these differences in the past – most notably counting the concentration of toxic subprime loans in low- and moderate-income (and minority) communities as outstanding CRA service. Therefore, the reality is that the Consumer Financial Protection Agency is critical in providing assessments of the positive and negative affects of different financial products and services. If there is no such agency, or no meaningful assessment of financial products defined within some other regulatory agency, then we doubt that the CRA assessments will do more than provide for the future development of abusive products concentrated in minority markets.

Setting a Floor Based on Existing Programs Services:

The original hope for the CRA was that as products and services were created for meeting the needs of underserved communities, the successful products would evolve into norms that would set a floor for all institutions that have the capacity to provide these services. In its existing form, CRA examinations are to place the institutions performance within that of comparable institutions. This peer group comparison, however, is only based on the asset size of the lender.

A floor needs to be set by requiring institutions to provide the kinds of reinvestment products that are provided in similar markets by other institutions. Of course, there may be leeway for the particular market niches of an institution or needs that are satisfied by additional or newly created products and services. This would create at least some process for the continuing evolution of a development banking industry.

<u>Put the Community Back Into the Community Reinvestment Act:</u>

Over time, the public has been removed from the CRA process by ignoring substantial challenges and by the so-called CRA provisions of the Gramm-Leach-Bliley Act that released lenders from being held accountable for CRA agreements but that placed onerous obligations on public parties that even suggested CRA activities. Therefore, the first action to reinstate the role of the public should be the repeal of the "Sunshine" provisions of the Gramm-Leach-Bliley Act.

If the CRA modernization does not include its own definition of the service areas (local assessment or community service areas), **a provision should provide for challenges to areas either defined by the institution or defined by the regulatory agency for each holding company entity.**

If the modernization includes a provision for a plan (including the assessment of local area needs and the definition of products and services to be provided), then **the Act should specifically provide for public comments and challenges to the plan.**

The modernization needs to provide for hearings for challenges to applications covered by the Act for all holding company entities where there would be covered applications at issue.

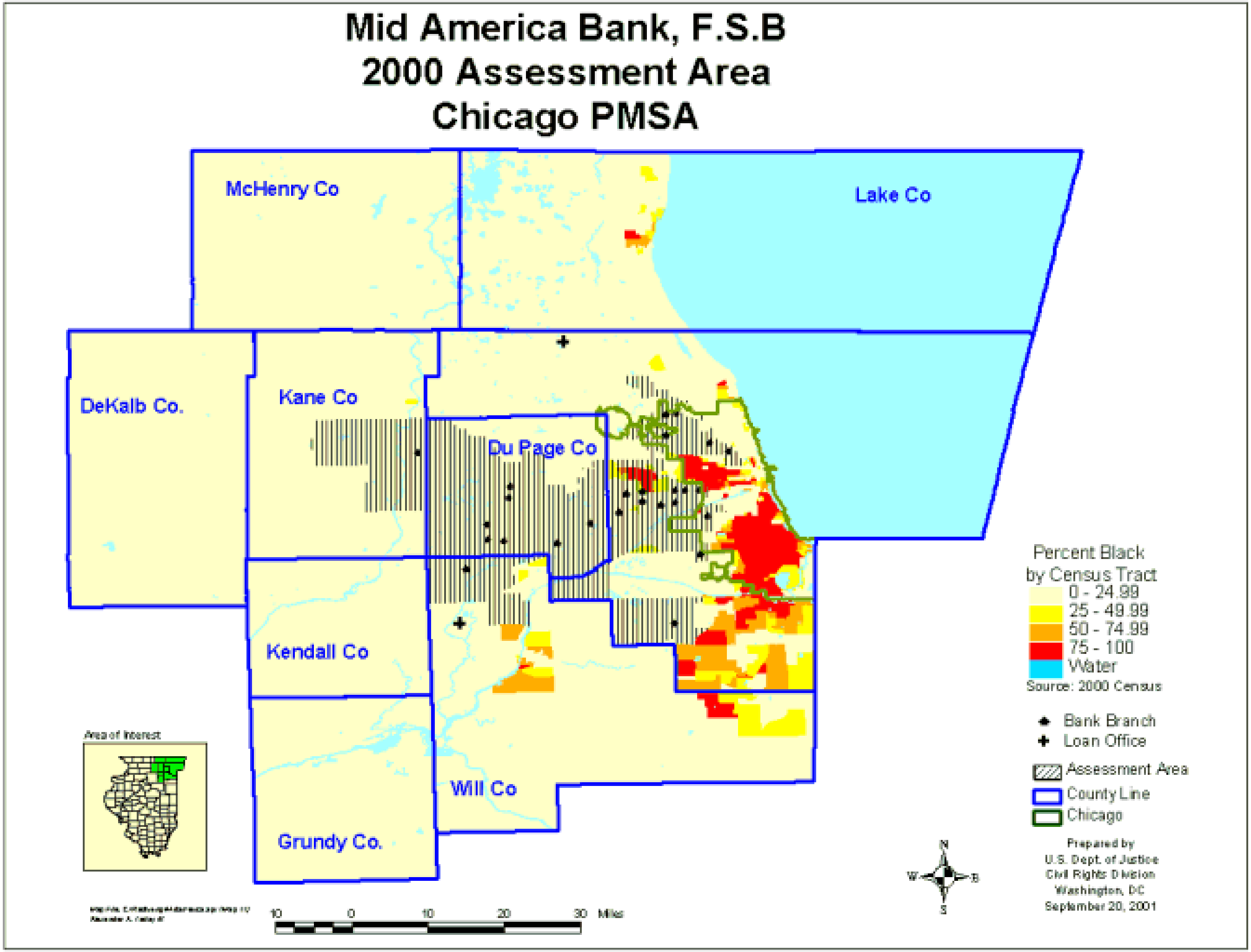
The modernization bill needs to provide for an appeal process to the assessments and ratings given to a holding company and its affiliates.

<u>Expanding the Stated Purpose of the CRA:</u>

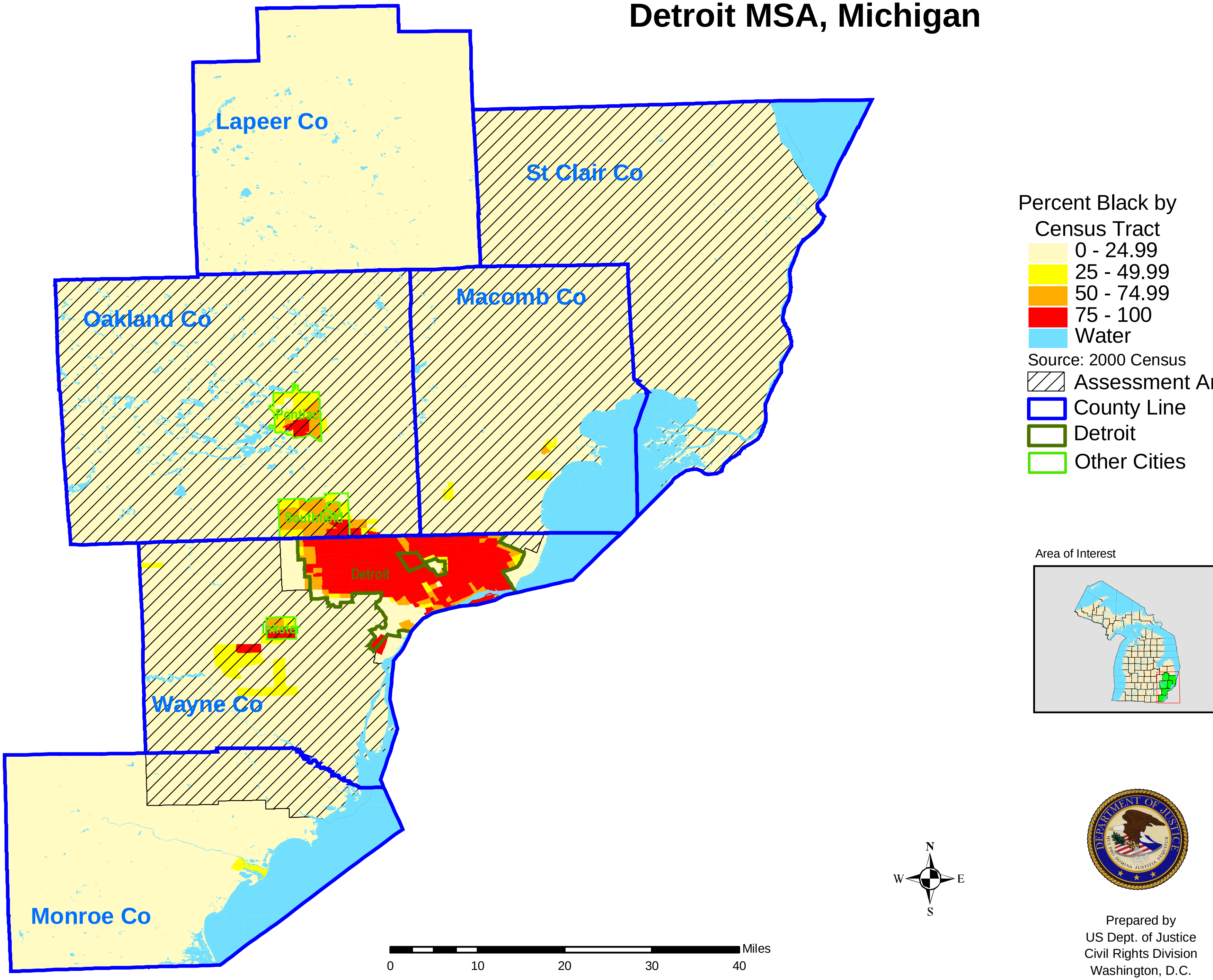
In order to accomplish the expanded role for the Community Reinvestment Act, the overall purpose of the Act also needs to be expanded. This is especially true in terms of including fair access to financial services and in the goal of supporting a viable development banking industry that has the tools to reinvest in any American community that is underserved or whose economy is lagging behind the rest of the country. For example, in the present Bill (HR 1479), the following highlighted language needs to be added to the purpose in order to make clear for the first time the fair access and development banking purposes of the Act.

To enhance the availability of capital, credit, and other banking and financial services for all citizens and communities, ***to provide additional resources to ensure fair access to all financial services and markets, to promote a development banking industry in the United states,*** to ensure that community reinvestment requirements are updated to account for changes in the financial industry and that reinvestment requirements keep pace as banks, securities firms, and other financial service providers become affiliates as a result of the enactment of the Gramm-Leach-Bliley Act, and for other purposes.

Complaint Exhibit 8 - United States of America v. Mid America Bank, fsb (N.D. Ill.)



Old Kent CRA Assessment Area as of March 2000
Detroit MSA, Michigan



Percent Minority (Non-White NH) Population by Year 1990 Census Tract
December 1998 Assessment Area
Gary MSA, Indiana