Lael Brainard: The Community Reinvestment Act - how can we preserve what works and make it better?

Speech by Ms Lael Brainard, Member of the Board of Governors of the Federal Reserve System, at the 2019 Just Economy Conference, National Community Reinvestment Coalition, Washington DC, 12 March 2019.

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It is a pleasure to have an opportunity to discuss how we can preserve what is working well with the Community Reinvestment Act (CRA) and make it better.[1] In recent months, we have seen a high level of engagement from banks and community organizations in discussions and comments about revising the CRA regulations, which serves as testament to the value of the CRA and provides valuable suggestions for improving our regulatory approach. The one message that comes through most clearly is that the CRA is highly valued by bankers and community groups alike. A second message is that the CRA could be even more effective in mobilizing community and economic development.

Purpose and History

Before offering some thoughts on what we have learned and some possible ways forward, I want to begin by recalling why the CRA was established and what it was designed to achieve, as well as the important role it has played for over 40 years in low- and moderate-income communities across this country.

The CRA was one of several landmark pieces of legislation to address inequities in the credit markets in the wake of the civil rights movement. The Fair Housing Act of 1968 and the Equal Credit Opportunity Act of 1974 addressed lending discrimination in mortgage and consumer credit based on race, sex, and other personal characteristics, while the Home Mortgage Disclosure Act (HMDA) of 1975 and later amendments recognized the importance of data in making these laws enforceable. In 1977, Congress passed the CRA to address the credit needs of low- and moderate-income neighborhoods. With the passage of the CRA, Congress aimed to reverse the urban disinvestment from years of government policies and market actions that deprived lower-income areas of credit by redlining—using red-inked lines to set apart neighborhoods that were deemed too risky.

The CRA is unique in important ways. Unlike previous government efforts to address the needs of lower-income areas, the CRA puts decisionmaking about a community's needs and priorities in the hands of local actors. By stipulating that banks have an affirmative and continuing obligation to meet the credit needs of all segments of the local communities they are chartered to serve, including low- and moderate-income communities, the CRA changed the way banks approach their lending and investment decisions in those communities. More than 40 years later, the CRA continues to animate a vibrant community development ecosystem connecting community members with the banks that lend and invest, community organizations that deliver services and develop housing, and state and local governments that direct incentives and subsidies. We participate actively through our community development and examination staff around the country, who help to connect stakeholders, analyze community needs, and assess outcomes.

A second unique feature is the public nature of evaluations. The CRA, as amended in 1989, directs federal regulators to evaluate banks' records of helping to meet the credit needs of their local communities and assign one of four statutorily mandated ratings to their performance.[2] Following additional amendments in 1991, the law requires that the agencies make public the banks' ratings and the analysis supporting them. The public nature of CRA evaluations provides a strong incentive for good performance as well as a platform for public input on community needs.

Opportunities for Improvement

Congress largely left it to the banking agencies to describe in regulations how they would evaluate a bank's CRA performance. This flexibility is valuable because it enables the agencies to revise the implementing regulations from time to time to keep the CRA relevant in response to technological innovation and other changes in the landscape for banking and community development financing.[3]

The agencies have discussed revising the CRA regulations on and off since 2010, when interagency hearings were held in several locations across the country. Last August, the Office of the Comptroller of the Currency (OCC) issued an Advance Notice of Proposed Rulemaking (ANPR) to request comments on a variety of questions related to defining the areas in which regulators evaluate a bank's CRA performance, clarifying and expanding the types of activities that are eligible for CRA consideration, and establishing a metrics-based approach to rating a bank's CRA performance, among other things. The OCC received nearly 1,500 comment letters in response to the ANPR, and we have been reading those letters with great interest.

To augment this analysis, since October, the Federal Reserve System has held more than 25 outreach meetings across the country with banks and community organizations, including representation from the other banking agencies, culminating in an in-depth research symposium at the Federal Reserve Bank of Philadelphia.

Several themes are emerging from the comment letters and outreach. Perhaps most important, stakeholders overwhelmingly support the CRA and its goals, noting a significant increase in loans and investments in low- and moderate-income communities since the law's enactment. Many commenters emphasize the importance of the CRA in supporting a vital community development ecosystem by bringing together banks, community organizations, state and local governments, educators, foundations, and other stakeholders to address community and economic development needs. Many cautioned the banking agencies to proceed carefully so as not to disturb this important ecosystem. I share this commitment to the CRA and to strengthening its role in community and economic development in the low- and moderate-income communities where it can make the greatest difference.

Defining a Bank's Community: Where Activities Count

Banks and community organizations agree that the regulations should better reflect the way in which banking products and services are currently delivered. Much has changed since the last major revision to the CRA regulations, which occurred at a time when physical branches were essential for all the deposit and lending needs of bank customers. The current definition of a bank's assessment area—the area in which a bank's performance is assessed—relies on the area around its main branches and deposit-taking automated teller machines (ATMs), which includes a substantial portion of its lending. The internet was just becoming available for commercial use when the current assessment area regulations were finalized. Since that time, technology and changing consumer preferences have led to banks gathering deposits and making loans well outside of their physical branches—for example, online and via mobile devices. So it is fair to ask whether the CRA's current assessment area definition adequately reflects the community a bank serves today.

Clearly, it is time to better define the area in which the agencies evaluate a bank's CRA activities, but it is important to retain a focus on the credit needs of local communities. As tempting as it may be to think that digital channels have rendered bank branches unnecessary, my discussions with banks and community stakeholders around the country have underscored the importance of branches as a venue for banks to engage with their communities. Branches are the places that provide the personal face-to-face assistance valued by many consumers and business customers. Moreover, branches provide a local presence for lenders to get to know the borrowers and the communities in which they live, lend, and invest. While technology has much to offer by way of convenience and customer experience, it is often a complement to rather than a replacement for bank branches. For this reason, and to be true to the original intent of the law, I believe that CRA evaluations should retain a focus on the credit needs of the local communities banks serve as indicated by their physical presence in those areas, but not be limited to where they have a physical presence.

Each quarter, I have been fortunate to make community visits around the country along with Board and Reserve Bank community development staff. I have seen firsthand the success of the CRA in bringing banks to the table along with community organizations to address complex community needs. Recently, I met with bankers in Denver, Colorado, who were working with local government officials and nonprofits to maintain affordable housing near newly developed public transit lines. In North St. Louis, I met with a community bank that was working with a place-based community development organization called Better Family Life to develop a micro-loan fund that is empowering low-income entrepreneurs.

In other places, particularly in high-poverty and rural areas, I saw firsthand how difficult it can be to get access to basic banking services. In a visit to the Mississippi Delta in 2016, I heard from community members about having to drive long distances to deposit a check or access an ATM. The same was true for my visits to Pine Ridge, South Dakota and some towns in the Appalachian region of Kentucky. There is a complex balancing between banks' need to operate branches profitably with communities' needs to connect to the financial mainstream, which we want to recognize in any revisions to the CRA regulations. Bankers and other commenters have emphasized the high value that bank branches have for retail customers and small business owners in underserved communities, and research corroborates this.

Similar to banks, community organization commenters support updating the CRA regulations as they relate to a bank's assessment area. They suggest retaining assessment areas around a bank's branches in order to retain the CRA's focus on local low- and moderate-income neighborhoods, while adding areas where banks conduct significant activity without branches.

Both bank and community organization commenters were open to having a larger area defined for the purposes of pursuing meaningful community development activities, particularly in cases where banks operate largely without branches. By allowing for more activity in a broader geographic area, they argue that the artificial competition for investments in areas served by several banks (such as New York or Salt Lake City)—so-called credit hot spots—could be mitigated. This could be to the benefit of credit deserts—those perennially underserved rural areas or small metropolitan areas that may not have a bank branch or, if they do, may not constitute a major market for purposes of banks' CRA evaluations.

In reflecting on these suggestions, we have been considering a possible approach that might rework the assessment area definition so that banks of a certain scale would have separate assessment areas for their retail activities and their community development activities. This would retain the law's focus on the credit needs of a bank's local community by evaluating the retail lending and services it offers in the county or other geographic area surrounding its branches, deposit-taking ATMs, and other concentrations of lending and deposit-taking.[4]

As part of this approach, a bank would get CRA consideration for community development activities in a more expansive area. Under the current rule, there is no ex ante certainty that a bank's community development activities will receive CRA consideration if they are in the broader statewide or regional area that includes the bank's assessment area. This current approach has proven challenging in practice, as banks sometimes invest in a community development activity only to find that their examiner doesn't agree that the activity is located within the bank's assessment area.

Community development activities, in order to achieve an appropriate scale, often operate in larger areas that may not neatly overlap with a bank's assessment area. A more expansive and ex ante clearer community development assessment area definition would afford CRA consideration for any such activity in a state where the bank has an assessment area. This approach would help eliminate uncertainty and could encourage more capital for affordable housing, community facilities, and economic development activities in underserved areas. Moreover, a broader assessment area for community development activities could help address the concentration of investment dollars in metropolitan areas where several banks may have branches, while other smaller metropolitan and rural areas remain chronically underserved.

My recent visit to the Pine Ridge Reservation in South Dakota brought home the importance of addressing the problem of credit hot spots and deserts that result from the CRA's current assessment area definition. I met with the Thunder Valley Community Development Corporation and viewed their impressive 34-acre mixed-use project to create a new commercial center for the reservation. When completed, it will include single-family and multifamily housing units, a boarding house for visitors, a community center, and a retail shopping area in a community where residents currently must drive an hour to reach a grocery store. In examining a list of all the project funders, it was noticeable that there were active financing commitments from many foundations, but no banks. Although this is likely to be a very impactful investment, there is only one bank currently whose assessment area may extend to Pine Ridge. In contrast, under the proposed community development assessment area approach, more of the banks with branches in Aberdeen, South Dakota, for instance, might be inclined to make such a community development loan with confidence it would get CRA consideration.

By creating separate assessment areas for retail and community development activities, we believe that banks would continue to place their community at the center of their retail lending and service activities while participating in meaningful community development opportunities that may have greater impact due to their broader reach.

Evaluating Community Development Performance: What Counts

In reflecting on the comments, listening sessions, and research conference, we have also been contemplating approaches to what community development activities count in order to provide greater predictability and better incentives. Banks and community organizations have noted that the current structure of the large bank performance tests may actually hinder community development financing in a couple of ways. First, under the existing approach, community development loans are considered in the lending test, while community development investments are considered in a separate test. A number of banks and community organizations argue that the form of community financing may be influenced more by the structure of the CRA performance tests than by what makes the most sense for the project. For example, if a bank is concerned about passing its lending test, it might structure financing as a loan rather than an investment to beef up its lending test performance even if an investment would be more effective.

Second, a number of banks and community organizations pressed the case for giving CRA consideration to any community development loan outstanding, rather than only those originated since the bank's last CRA evaluation. Under the current rule, banks often make short-term, renewable community development loans simply to ensure that the incremental lending receives CRA consideration at each examination. By contrast, when it comes to investments, all investments on the bank's books at the time of the evaluation are given consideration. Banks and community organizations alike make a compelling argument that all types of community development finance, whether in the form of a loan or an investment, have greater impact when they serve as patient, reliable, committed sources of financing.

One possible approach to address these distortions and provide more effective incentives is to create a separate, comprehensive community development test to evaluate community development loans and qualified investments through a similar lens, possibly along with community development services. A separate, comprehensive community development test could encourage banks to provide the patient, committed financing—in the form of loans as well as investments—that community development organizations value the most. This is important because banks are uniquely situated to evaluate the community development finance projects in the states where they operate and to provide the smaller, more complex, and often more impactful, investments that don't attract institutional investors. If banks cannot be confident ex ante that they will get the benefit of CRA consideration for these efforts, which may be time-consuming to evaluate and structure, it is not surprising they would instead gravitate toward activities they know will count.[5]

In addition to these broad changes to what and how community development activities should be counted, we recognize there are several definitional issues that merit consideration. For example, many commenters advocated for an expansion of the definition of "community development" to include loans to or investments in community development financial institutions (CDFIs), regardless of the bank's assessment area, because the sole purpose of CDFIs is community development. There are also suggestions that in high-poverty rural areas, where incomes overall may be low relative to federal benchmarks, it may be helpful to adjust the definition of what qualifies as low- and moderate-income so that more CRA activity receives consideration, which we will study.

Tailoring

Recognition of the variation in how banks deliver their products and services brings me to the third theme expressed by both banks and community organizations, which is the need for the CRA regulations to be flexible enough to evaluate banks of widely different sizes and business strategies. Different perspectives were offered about some aspects of how to better tailor the regulations, particularly with regards to whether more banks should be considered "small" and, as such, eligible for a streamlined evaluation.

Indeed, one of the benefits of creating separate assessment area definitions and performance tests for retail activities and community development activities could be streamlining the tests and applying them in different ways to tailor CRA evaluations to banks based on their size and business strategy. Small banks could have their lending and retail services evaluated under the retail test, while larger banks could be evaluated under both the retail and community development tests. The assessment area definition could be flexible enough to allow banks that conduct most or all of their retail activity online to identify states in which they have a significant level of deposits, lending, or other banking activity in which they would have obligations under either the retail or community development test, as appropriate.

Consistency and Predictability

There was also wide support for making CRA definitions and evaluation criteria clearer and taking other actions to improve the consistent and predictable application of the regulations during evaluations. Perhaps more important, the commenters strongly supported the agencies continuing the tradition of working together to have one set of rules, consistent interpretive guidance, and regular examiner training to ensure that the CRA is implemented as consistently as possible both within and across the agencies. At the Federal Reserve, we agree that it is important for the banking agencies to take a consistent approach.

Metrics

Finally, there was broad support for expanding the use of metrics in CRA evaluations, where appropriate, especially if they are clearly articulated, are used in tandem with performance context information, and add to the transparency of CRA ratings. We recognize that effective and predictable evaluations rely on good metrics. Metrics, in turn, require good data. Currently, CRA evaluations use HMDA data, which are very useful in understanding where mortgages are made, to whom, and at what cost. Moreover, HMDA data are collected from both banks and non-bank mortgage lenders. But the data collected under CRA to support our analysis of small business and small farm loans are not as comprehensive as mortgage lending data. The Dodd-Frank Wall Street Reform and Consumer Protection Act charges the Consumer Financial Protection Bureau with promulgating regulations for the collection of small business loans, and that data should be very helpful when they become available. Separately, the data collected under the CRA on community development loans are not adequate to support the analysis of a separate community development test, so it may be necessary to consider a better reporting system.

Collecting data and developing clear metrics will provide the improved clarity and ex ante predictability that banks seek. More and better data will allow for more meaningful metrics by which we can evaluate performance criteria, such as the borrower and geographic distribution of lending and how a bank's performance compares with other similarly situated banks. We may also consider providing more baseline information that describes a bank's performance context, such as the demographic and economic information that helps to describe the credit needs and opportunities present in each assessment area. In addition, there may be ways to more effectively incorporate community engagement into the process—for example, by having the banking agencies develop a joint community contacts database to facilitate access to information from local community stakeholders.

Conclusion

Overall, I have been impressed with the number of organizations that took the time to comment on the OCC's ANPR to and attend the Federal Reserve's outreach meetings. It is encouraging to see the high level of commitment to the CRA from banks and community organizations alike. As we think about the path forward, it is important that we retain the CRA's core focus on place while improving upon the regulation's flexibility in order to provide meaningful CRA evaluations of banks that largely deliver their products and services digitally. We want whatever we design to be clear and more predictable for banks in order to promote more and more impactful CRA activity.

Taken together, changes to the CRA regulations' definition of assessment areas and performance test structure, along with improved metrics based on better data have the potential to enhance the regulations and better serve its purpose of encouraging banks to help meet the credit needs of low- and moderate-income communities. We understand and appreciate that banks want to be able to make plans and manage their risks carefully through clearer standards regarding what counts, where it will be counted, and how. If we can address these suggestions effectively, banks will be more effective in addressing the needs of their local communities and in some cases extend their activities to benefit chronically underserved communities.

I will be interested to hear whether some of the ideas I have shared today resonate with you. I want to assure you that we will continue to engage with bank and community stakeholders to find a path forward that honors the purpose of the CRA by encouraging banks to attend to the credit needs of their local communities and to better address the needs of underserved areas. This engagement will be vital as we join together with the other banking agencies to formulate regulatory changes that preserve what is best about CRA while ensuring its value and relevance for another generation.

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[1] I am grateful to Theresa Stark of the Federal Reserve Board for her assistance in preparing this text. These remarks represent my own views, which do not necessarily represent those of the Federal Reserve Board or the Federal Open Market Committee.

[2] The banking agencies are the Federal Reserve, the Office of the Comptroller of the Currency, and the Federal

Deposit Insurance Corporation. The ratings are: Outstanding, Satisfactory, Needs to Improve, and Substantial Non-compliance.

3 The current regulatory structure dates back to 1995 when the agencies reworked the regulations to provide for a variety of evaluation methods for banks of different sizes and business strategies and set out criteria by which a bank's lending, investment, and service activities in its community are evaluated. There were further regulatory revisions in 2005.

4 The agencies could consider requiring assessment areas around a bank's other physical locations, such as loan production or trust offices, or in areas where the bank has significant deposit or lending activity.

5 We recognize that the agencies will need to give careful consideration to how to weight community development loans, investments, and services, so as not to harm the complex system of community development financing that is dependent largely on CRA-motivated investments.