

# REINVESTMENT ALERT

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A Woodstock Institute Bulletin

February 1994 Bulletin 4

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## NEW CRA REGULATIONS WILL BENEFIT COMMUNITY GROUPS BY STRESSING OBJECTIVE MEASURES OF BANK LENDING

### Introduction

New regulations have been proposed for the Community Reinvestment Act (CRA) which could produce increased lending in low- and moderate-income neighborhoods. This Alert describes some of the key features of the proposed regulations, and their advantages and disadvantages. The public comment period on the regulations ends March 24, 1994. Community groups now have an opportunity to press for changes in the regulations that could increase community reinvestment lending.

In July 1993, President Clinton asked the four federal banking regulators to take a fresh look at the regulations which govern the implementation of the Community Reinvestment Act. By December, the regulators published draft regulations for public comment.

The proposed regulations change the focus of the CRA examination from process (e.g., how many meetings did banks hold with community groups?) to outcomes (e.g., how many loans were made in low-income neighborhoods?). In particular, the new CRA regulations emphasis on objective standards holds the promise of increased lending in communities lacking vibrant economies. Banks and community groups alike can profit from these reforms.

While this Alert describes key features of the proposed changes, the proposed regulations are quite complex. Further details can be obtained from the Woodstock Institute.

### Key Changes

#### The Lending Test

Financial institutions that have more than \$250 million in assets will be examined under three tests: the lending, investment, and services tests. The lending test is

the most important for retail banks. To get a good grade under the lending test, banks will have to demonstrate that their market share of home mortgage, small business and consumer loans is as high in low- and moderate-income neighborhoods as it is in the rest of their service areas. These ratios will be used to compare banks to each other to assess the lending activity each is achieving in their market.

The lending test returns the CRA to its original purpose--guaranteeing that low-income communities are not deprived access to basic credit. The lending test is not credit allocation. The regulations do not require any bank or savings and loan to offer a fixed amount of any particular product or service or to commit to any required number of investments or grants. The lending tests are comparative. Banks will be judged by their own record of lending in different income communities and against the records of similarly situated banks.

### **The Investment Test**

The main test for wholesale banks who lend mainly to mid- and large-size companies will be the investment test. This test will measure lending to low- and moderate-income neighborhoods and individuals banks make through intermediary organizations such as community development financial institutions, community development corporations and state and local housing and revenue bonds. The amount of lending will be measured against the bank's capital. As in the lending test, the investment test will give a numerical value to a bank's reinvestment efforts that will allow regulators and community groups to see if a bank is improving and how it performs compared to similar banks.

### **The Service Test**

The final test is the service test which will measure whether a retail bank has branches that are in, or readily accessible to, low- and moderate-income neighborhoods.

### **The Plan Option**

Instead of being examined under the lending, investment and service tests, a bank could choose to submit a CRA plan which had measurable goals. The bank would then be evaluated on whether or not it achieved the goals in the CRA plan. A bank would be required to publish the plan and the plan would be open to public comment before the regulators approved it.

### **Small Banks (Under \$250 million in assets)**

Small banks comprise 75 percent of all lenders in the country and their assets amount to 20 percent of all bank assets. Small banks will not be subject to the

lending, investment and service tests but will instead receive a satisfactory rating if they meet the following standards:

1. The lender has a reasonable loan-to-deposit ratio (60 percent and above);
2. The lender makes a majority of its loans in its service area;
3. The lender lends to a range of income groups and offers different types of loans;
4. The lender has not engaged in discrimination and has received no bona fide complaints from community groups

### **Advantages of the Proposed Regulations**

- \* Banks will be measured on actual loans and investments and on how many loans they make in lower income neighborhoods compared to middle income neighborhoods.
- \* Because of the new data, community groups will be able to tell whether a bank's lending has improved and whether a bank is doing as well as similar banks.
- \* The lending test returns the CRA to its original purpose--guaranteeing that low-income neighborhoods are not deprived access to credit. The lending test is not credit allocation as some banks charge. It does not require a bank to offer a fixed amount of loans. Instead, the test is comparative. Banks will be judged by their own record of lending in different income communities and against the record of similar banks.
- \* For the first time, banks will have to report data on small business loans and consumer loans. Small business loans are critical to the revitalization of poorer neighborhoods. This data will show which banks are making small business loans.
- \* By discarding the 12 assessment factors, the new regulations get rid of much of the unnecessary paperwork and ambiguity banks dislike.
- \* The proposed regulations include enforcement sanctions such as cease and desist orders and civil money penalties. Under the old CRA system, banks only had to worry about their CRA rating when they applied to regulators to merge or acquire another institution. For financial institutions unlikely to be acquired, or to acquire another institution in the short term, the current penalty is not effective.

- \* The investment test creates, for the first time, a specific test for wholesale and special purpose banks. Such banks have traditionally escaped CRA review and CRA protests.

## **Problems with the Proposed Regulations**

- \* Banks who do poorly on the lending test, will be able to upgrade their final score by good ratings on the investment test. While the investment test is important, banks with poor lending test ratings should receive poor final ratings.
- \* Small banks should not be exempt from the key tests. While they should not have to document as much as large banks, smaller institutions should be subject to a modified version of the three tests.
- \* All banks, whether or not they choose the plan option, should be required to produce a community credit needs assessment and a plan for responding to community credit needs.
- \* Due to protests from Federal Reserve Board members, the new small business and consumer loan disclosure provisions do not require data on the race, gender and income of loan applicants. These data are critical to judging a bank's reinvestment efforts. There is a proven history of discrimination in home mortgage lending, and it is critical that data are collected to measure denial rates across race, income, and gender lines.
- \* The proposed lending test does not include mortgage bank lending in the calculation of a bank's market share. In communities with substantial mortgage bank lending, the lending test, absent the inclusion of mortgage bank data, will exaggerate the actual lending performance of depositories and savings and loans.
- \* The new regulations do not require examiners to look at how a bank selects its service area. If the market share ratios required under the lending test are to be meaningful, the regulators must examine how banks draw their service areas.

## **Community Groups Should Comment on the Proposed Regulations**

Many banks and the Federal Reserve Board have objected to the new regulations. While these regulations have flaws, they are in other respects a huge improvement on the old regulations. The regulators need to hear from community groups about

what they like and don't like about the proposed changes. The proposed regulations are a chance in a generation to concentrate CRA on performance not promises.

To make your voice heard write to the following regulators, making sure that your comments arrive on or before **March 24, 1993**:

OCC: Communications Division, Office of the Comptroller of the Currency, 250 E Street, SW, Washington DC 20219, Attention: Docket No. 93-

Federal Reserve Board: William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Ave. NW, Washington DC 20551

FDIC: Hoyle L. Robinson, Executive Secretary, FDIC, 550 17th Street, NW, Washington DC 20429

OTS: Director, Information Services Division, Public Affairs, Office of Thrift Supervision, 1700 G Street, NW, Washington DC 20552, Attention Docket No. 93-

**For More Information contact:** Malcolm Bush, Kathryn Tholin, Daniel Immergluck at the Woodstock Institute, (312) 427-8070.

