

REINVESTMENT ALERT

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SAVING CRA REFORM: KEY PERFORMANCE, DISCLOSURE MEASURES THREATENED

Background

In December 1993, the federal banking regulators, responding to direction from President Clinton, put out a set of proposed regulations to reform and improve the implementation of the Community Reinvestment Act. After receiving thousands of comments, most of which came from banks and savings and loans, the regulators recently put out a revised proposal. This revised proposal effectively guts two of the key CRA reforms, reforms critical to improving access to business credit in lower-income neighborhoods and to encouraging banks to support and develop creative economic development programs. First, perhaps as important as any other component of the original proposal, was one calling for collecting and disclosing small business loan application and origination data for banks and savings and loans by census tract. Second, the original proposal called for the use of some objective measures as key indicators of a bank's responsiveness to credit and capital needs. On both these central changes, the revised proposal is a substantial retreat from earlier progress.

In addition to these major issues, there are a number of secondary issues in the revised proposal. Key issues are described below. For more detailed information on the proposed changes, contact Malcolm Bush, Kathy Tholin or Dan Immergluck at the Woodstock Institute, (312) 427-8070.

Comments on the revised proposal that threatens these key improvements must be made in the next two to three weeks, and are desperately needed to salvage meaningful reform.

The Need for Small Business Loan Data

Although CRA has been only a partial success in improving access to housing loans, it is clear that the combination of CRA and the earlier Home Mortgage Disclosure Act has contributed to increased residential lending in low- and moderate-income urban neighborhoods. Federal Reserve Chairman Alan Greenspan himself has lamented the fact that CRA has not been as effectively used in the area of small business lending.

The lack of data on small business loans has clearly been a primary contributor to this imbalance. Community development organizations, policy groups and researchers have come to the table armed with housing loan data, making it easier to identify residential credit needs and to argue for policies and programs to address these needs. Pushed by housing activists utilizing CRA, many banks themselves have become advocates for housing subsidies and programs to spur development of affordable housing.

It is clear that CRA has played a lesser role in spurring business development in low- and moderate-income urban neighborhoods, and has left minorities with inferior access to business credit. A 1987 Woodstock Institute report on commercial lending patterns by 28 Chicago banks, which accounted for the bulk of the bank assets in the area, showed that, after excluding 12 census tracts in the downtown area, city neighborhoods received less than 4 percent of all commercial lending dollars from these banks. And a 1992 study of 7,000 new firms in the *Journal of Urban Affairs* found that, after controlling for management experience, age and other characteristics, white males received more than \$2 in bank credit for every dollar of equity they put in their business, while African American males received less than \$.70 for every dollar of equity. Related research also found that minority-owned firms located in lower-income neighborhoods have poorer access to credit than minority firms in other areas.

The revised proposal calls for collecting, *but not disclosing to the public*, data on small business loans by census tract. No information will be disclosed that enables organizations to understand lending patterns in particular communities. This will not only destroy the utility of the data, it is also objectionable in principle. **Small business lending data collected by the regulators must be disclosed to the public for CRA to continue to be an effective tool.**

Retreat from Performance Standards

A second critical shortfall in the most recent version of the new regulations is the retrenchment from the use of some objective measures of bank lending performance. One of the centerpieces of the original reform proposal was the analysis of a bank's market shares in lower-income areas compared to their shares in middle and upper income areas. While not sufficient to judge bank performance, this measure provides important information by which institutions can be compared.

The current proposal abandons all standardized performance indicators, leaving it up to an examiner to determine how to measure and evaluate an individual institution's performance. While the use of objective measures, by themselves, may not be sufficient to evaluate a bank's CRA performance, the absence of such measures will mean that the quality of such evaluations will remain inconsistent and depend upon the attitude of particular regulatory agencies and staff. Ironically, banks have complained for years about the vagueness of CRA regulation. Numerical measures are used throughout the industry. There are always complexities and subtleties, but this does not mean that such indicators are abandoned. It merely means that the measures are used to provide a basis for more complete evaluation.

Performance-based evaluations require some use of consistent performance-based measurements. **Market share measurements should be calculated for every bank and included in CRA exams as one component of an institution's evaluation.**

Absence of Race and Gender Criteria

Under the revised regulation, race and gender play no direct role in assessing a bank's performance in the lending test despite the fact that minority communities and individuals, as well as women, face widespread discrimination in the credit markets. We know that minority neighborhoods are treated differently than non-minority neighborhoods in access to credit and in the variety of loan products offered, yet the proposed lending test ignores this critical dimension of the CRA.

The lending test should include in the geographic criteria section the percentage of loans that were made in minority and non-minority census tracts for each major racial and ethnic group. The borrower characteristic section should include the number of loans to individual borrowers by racial and ethnic group.

Race and gender should be included as criteria in the assessment of a bank's lending performance.

The Too-Lenient Grading System

The current proposals call for arriving at a final CRA grade for all non-wholesale banks by totaling numerical scores attached to three tests--lending, investment, and services. Changes from the December proposal require institutions to receive at least a "low satisfactory" on the lending test in order to receive a composite Satisfactory rating, and reflect the importance of the lending component by awarding it twice as many possible points as the other two tests. However, the scoring system allows an institution to receive, for example, a Low Satisfactory on both lending and service, and a Substantial Noncompliance on the investment test, and still receive an overall Satisfactory rating. By the same token, an institution can receive an Outstanding rating on lending and services, and a Substantial Noncompliance on the investment test, and still receive an Outstanding composite rating.

If Substantial Noncompliance is to mean what it says, any Substantial Noncompliance component grade should have significant consequences for the institution. In addition, the composite scale is too lenient, allowing an institution to "pass" with only 9 of 24 possible points (or 38%). Without modifications, virtually all institutions will pass, and the investment and service tests become largely irrelevant.

A Substantial Noncompliance grade for any component should result in at best an overall Needs to Improve rating. In addition, the minimum score necessary to earn a Satisfactory rating should be raised to 11 point out of 24 (from 9), and the minimum score to achieve an Outstanding should be raised to 20 points (from 18).

With these minimums, the minimum performance 3 for a Satisfactory rating would be Low Satisfactory in lending, service and investment, or a High Satisfactory in lending, a Low Satisfactory in service, and a Needs to Improve in investment. An Outstanding would require an Outstanding rating in lending and either two High Satisfactories or an Outstanding and a Low Satisfactory in service and investment.

Small Business Definitions Too Broad

In several instances, the revised regulations call for counting, as eligible for CRA credit, loans, investments or services that primarily benefit "business or farms that qualify as a business under a Small Business Administration program." But current SBA regulations define eligible small businesses as including manufacturers with as many as 1,500 employees. So, loans to 1,000 employee firms in middle-income suburban areas would potentially be eligible as community development loans.

The definitions and eligibility of loans and services to small businesses should be restricted to businesses that are truly small, and preference should be given to activities affecting firms in low- and moderate-income areas. Activities affecting firms with sales in excess of \$5 million, especially those not located in low- or moderate-income areas, should not be counted under any test.

Action is Needed by You

The prognosis for saving these essential ingredients in CRA reform is not very good currently. Of the more than 6,000 comments on the original proposal, only 15 percent came from community and consumer-oriented organizations. The banking industry, in general, has pulled out the stops on defeating these key reforms. **A much better response from community-based organizations is needed in this second round of comments.** To be meaningful, CRA reform must push institutions to support more community development efforts and to create sustaining programs to reach the needs of more neighborhood business in Chicago and elsewhere. Comments on the revised proposal are due by **November 21, 1994**. A sample letter with the addresses of the regulators is attached. Please make the time to make your comments known to the regulators.

SAMPLE LETTER

LETTER MUST BE RECEIVED BY NOVEMBER 21, 1994

Address separate letters to each of the following:

Communications Division
Office of Comptroller of the Currency
250 E. Street, SW
Washington, DC 20219

William W. Wiles
Federal Reserve Board
Docket R-0822
20th St. and Constitution Ave., NW
Washington, DC 20551

Robert E. Feldman
Acting Executive Secretary
FDIC
550 17th Street, NW
Washington, DC 20429

Director
Information Services
Public Affairs
Office of Thrift Supervision
1700 G. Street, NW
Washington, DC 20552

Dear Sir or Madam:

I am writing to comment on the proposed reform of Community Reinvestment Act regulations. _____ (YOUR ORGANIZATION) is _____ (DESCRIBE YOUR ORGANIZATION.) While we have seen some progress in the performance of banks in our area, we see the need for much more attention to the credit needs of our community.

We are seriously concerned that the proposal to revise CRA regulations have been severely weakened in several key areas. First, the disclosure of small business loan activity is critical to our ability to assess the credit needs of local business, to examine the lending of nearby and larger banks, and to marshal support for our initiatives. As structured in the revised proposal, the minimal metropolitan data will not serve these purposes. **We urge you to retain the small business reporting data by census tract as proposed in the original proposal, with the addition of data on race and gender of applicants and borrowers.** We need this data to be disclosed and want you to use it in assessing CRA performance.

Second, we are also concerned with the overall shift away from the use of some objective measures in comparing the performance of financial institutions in serving their communities. We understand that CRA is a complex issue and that neighborhoods and institutions vary greatly. But, without some basic measures on which to build, CRA will remain severely limited, with many banks receiving satisfactory ratings that may not deserve them. **We urge you to retain some key measures, including the market share test, and use them in conducting CRA exams to provide a basis for comparing lenders' CRA performance.**

Third, while the current proposals give appropriate priority to lending performance in the grading system, the current point system allows institutions to pass with less than 38 percent of total points, and makes the investment and service tests largely irrelevant. **No institution should receive a satisfactory or better if it receives a Substantial Noncompliance in either the investment or services test.**

Improving CRA requires first, better measurements and evaluation of CRA performance and second, available information that can be used by the public as well as by examiners to assess that performance. The current regulations as proposed seriously weaken both components; the changes outlined here are essential to a meaningful revision of the Community Reinvestment Act.

Thank you for your consideration.

Sincerely,

