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THE *COMMUNITY REINVESTMENT ACT* (CRA): UNITED STATES CREDIT LEGISLATION

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INTRODUCTION

For several decades, United States financial institutions such as banks and "thrift institutions" have been subject to a federal regulatory mechanism aimed at encouraging them to extend credit needed by their local communities. During the 1970s, increasing mistrust of financial institutions led the United States Congress to adopt a series of legislative measures for ensuring "fair lending" and overcoming problems of discrimination. Two of these statutes, the *Fair Housing Act* (FHA) and the *Equal Credit Opportunity Act* (ECOA), prohibit discrimination on the basis of individual characteristics in housing credit and all other types of credit transactions; the *Community Reinvestment Act* (CRA) provides anti-discrimination and community development incentives and is aimed at encouraging lenders to meet the credit needs of their local communities, including low- and moderate-income neighbourhoods. The data used to evaluate the CRA, the FHA and the ECOA are obtained under the *Home Mortgage Disclosure Act* (*HMDA*), which allows regulatory agencies and members of the public to obtain information for detecting discrimination.

Among the pieces of legislation adopted during that period, the CRA is noteworthy. It gives the agencies governing the financial services industry regulatory and persuasive powers that go beyond traditional financial measures and do not conflict with these agencies' responsibilities for ensuring the soundness of the financial services industry. During the 1990s, the CRA and its accompanying regulations were overhauled at the same time as additional programs were created to provide financial support to and reward financial institutions that achieved the CRA objectives. This overhaul led to legislative and regulatory amendments that were phased in up to July 1997. Under the amended legislation, thousands of CRA-regulated financial institutions in the United States are still strongly encouraged to collect data,

which are then collated, published and used to evaluate performance. The data are provided on the basis of census groups, such as statistical metropolitan areas, by income and other parameters. Performance evaluations also cover the institutions' activities (usually lending, investing, and providing services), which are rated according to tests or set out in duly approved strategic plans. Performance is a factor in the decisions of regulatory agencies with respect to applications by institutions to expand or change their activities under the CRA.

This paper will briefly study the main features of this United States legislation.

PURPOSE OF THE CRA AND MANDATE OF REGULATORY AGENCIES

The main purpose of the CRA is to prohibit instances where the non-extension of credit would penalize low- or moderate-income neighbourhoods. This requires the four federal agencies governing the United States financial services industry to take the necessary regulatory action to encourage their members – banks and thrift institutions – to meet the credit needs of their local communities, in accordance with sound financial practices. These four regulatory agencies are: for banks, the Comptroller of Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation; and, for thrift institutions, the Director of the Office of Thrift Supervision. The CRA gives these agencies responsibilities in addition to their usual powers.

Under the CRA, in order to encourage their member institutions to meet the credit needs of their local communities, the four regulatory agencies must:

- evaluate the performance of member financial institutions in extending credit to the entire local community, including low- and moderate-income neighbourhoods;
- take the performance of member institutions into account before approving their applications to expand or change their activities;
- in their respective annual reports, report on measures taken under their CRA responsibilities;
- publish the regulations used to implement the CRA; and
- prepare written (and partially confidential) performance evaluations of CRA-regulated member institutions, taking into account the fact that the activities of some institutions are carried out in metropolitan areas or in more than one state.

Since the regulatory agencies must take the performance of CRA-regulated member institutions into account before approving their applications for receiving a charter, obtaining deposit insurance coverage, carrying out branch activities, or merging, the regulatory agencies can sometimes exercise a persuasive power.

The following table provides greater detail about activities requiring regulatory agency approval under the CRA.

ACTIVITIES REQUIRING REGULATORY AGENCY APPROVAL UNDER THE *CRA*
APPLICATIONS THAT MAY BE REFUSED UNDER THE *CRA*

Subject of Application	*Description*
Charter	Charter application by national banks or federal savings and loan associations
Deposit insurance	Deposit insurance application by recently chartered financial institutions such as state banks, savings banks, or savings and loan associations
Branches and deposit-taking facilities	Application by a deposit-taking institution to open a branch or additional facility in the United States
Move	Application by a financial institution to change the location of its headquarters or a branch
Merger, acquisition	Application by a financial institution to merge, consolidate activities with another institution, or acquire assets (or liabilities) of a financial institution under the CRA or Part IV of the *National Housing Act* (NHA)
Share acquisition	Application to acquire shares or assets of a financial institution requiring approval under section 1842 of the chapter on banks or section 498(e) of the *NHA*
Source: *Banks & Banking*, Chapter 30, “Community Reinvestment”, 12 USC.	

The CRA provides that financial institutions’ applications to change their activities must be evaluated by the appropriate regulatory agencies, which will take into account the institutions’ performance in meeting the credit needs of their local communities, including low- and moderate-income neighbourhoods. Financial institutions submitting applications under the CRA usually do obtain approval from the appropriate regulatory agencies. The CRA does not mention the persuasive powers that may be exercised over CRA-regulated financial institutions that need not submit specific applications in order to carry out their activities during a given period, but the co-operation of all CRA-regulated financial institutions is probably encouraged by market pressure and community development advocacy groups.

LEGISLATIVE AMENDMENTS

After its initial passage in 1997, the CRA underwent a number of amendments as a result of changes to other legislation. As well, in 1993, at the request of the United States President, the regulatory agencies undertook to revise their regulations to bring them into line with a system based on performance evaluation, particularly in low- and moderate-income neighbourhoods. In May 1995, after producing two drafts and numerous commentaries, the CRA regulatory agencies produced the revised regulations.

Although these revised regulations, enacted in May 1995, did not affect the persuasive powers of the CRA regulatory agencies, they did introduce criteria and a process more focused on:

- evaluation of results;
- increased use of the regulatory agencies' discretionary powers; and
- obtaining performance evaluations based on better data, particularly data better adjusted to the size of the lending institutions.

While the new regulations under the CRA were being phased in, a process that was completed by July 1997, additional community development legislation was introduced. In 1994, Congress created a fund under the Community Development Financial Institutions Program (CDFI) aimed at broadening access to credit and financial services, particularly in disadvantaged neighbourhoods. The fund has two parts:(1) the first, which has the same name as the main CDFI Program, provides a range of financial institutions with technical and financial assistance for community development; the second, the Bank Enterprise Award (BEA), rewards banks that enter into partnerships to assist community development financial institutions. According to a 1998 General Accounting Office (GAO) report on community development programs, the obligation to meet CRA criteria is partly responsible for some banks' readiness to invest in the community development financial institutions and disadvantaged neighbourhoods targeted by the CDFI.

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(1) In 1996, the CDIF Program obtained assistance totalling US$35 million for 31 of 268 applicant financial institutions. Under the Bank Enterprise Award (BEA), 38 of 50 applicant banks received rewards totalling US$13.1 million for increased projected investments in community development institutions and disadvantaged areas.

INFORMATION PROVIDED TO MEMBERS OF THE PUBLIC

The regulatory agencies are not alone in publishing their performance evaluations. The regulations also encourage financial institutions to provide certain information to members of the public and facilitate public participation in the evaluation or approval of applications. Although the regulatory agencies usually report on cases involving public complaints or opposition, this practice rarely affects final evaluations or approvals. In its 1997 annual report, the Federal Reserve Board states that it took public objections into account in carrying out the CRA performance evaluations of a certain number of institutions under the CRA.

> [In 1997, the Federal Reserve] Board acted on bank and bank holding company applications that involved *Community Reinvestment Act* (CRA) protests, adverse CRA ratings, and issues of fair lending and non-compliance with consumer protection regulations. Several applications involving major bank mergers elicited both strong support and strong opposition from members of the public; all were protested on CRA grounds. After extensive analysis, the Board approved all these applications, finding in each case that convenience and needs factors were consistent with approval.

A March 1998 Federal Reserve Bank of Chicago report available on the Internet provides an indication of the information available to members of the public as a result of the regulatory agencies' evaluations of their members' performance. This report shows a correspondence between credit extended and business density in a given area. It also shows that, according to 1996 data, where regions are divided into sectors of varying incomes the percentage of credit extended in low- and moderate-income neighbourhoods in a census area is lower than the proportion of area businesses located in those neighbourhoods. The report further indicates that 1996 results for the Chicago district reflect national results, and that the number of loans extended per 100 businesses in low- and moderate-income neighbourhoods is between 60% and 90% of the number of loans extended in a census area a whole.

PERFORMANCE EVALUATIONS

The new regulations accompanying the CRA are applied differently depending on the size and activity type of financial institutions (see box for further details on the tests used in

performance evaluations). In general, the regulatory agencies use three tests to carry out comprehensive evaluations of the extent to which member institutions are achieving the CRA objectives: one on lending; one on providing retail and community development services; and one on investing (if this activity has not already been evaluated through the tests on lending and providing services). If authorized by the appropriate regulatory agency, institutions may choose another method of evaluation using a strategic plan. As an indication, in 1997 the Federal Reserve System carried out 586 evaluations: 460 on institutions able to use criteria applicable to small institutions; 86 on institutions able to use the old regulations for the last time; and 39 on institutions using the tests on lending, providing services, and investing. In addition, one institution had a strategic plan approved, and four received authorization to be designated as wholesale financial institutions and evaluated accordingly.

Reporting by the regulatory agencies is not standardized. Some agencies use consolidated reports, while others provide public access to the performance evaluations of individual financial institutions. According to information obtained from the Internet, the performances of several hundred financial institutions are rated each year by the appropriate regulatory agencies as "superior," "satisfactory," "needing improvement," or "failing to meet requirements." In 1997, 500 evaluations carried out by the Comptroller of Currency, 18% institutions rated as superior; 75% as satisfactory; 3% as needing improvement, and 1% as failing to meet requirements.

PERFORMANCE EVALUATIONS: THE TESTS

In general, the tests measure the quantity and quality (for example, frequency, amount, percentage, concentration, originality, and appropriateness) of financial institutions' activities by geographic area and by client type, particularly for low- and moderate-income clients. Data on credit extended are particularly important for overall evaluations, which can nonetheless be affected by the tests. The regulations include specific requirements, depending on institution size, for gathering and presenting data on small businesses, community development, and mortgage and consumer credit extended including location, frequency and amount, as well as client business size.

Under certain conditions, some financial institutions may choose other forms of regulatory performance evaluation. There is a special test for small institutions, although they need not use this test if they pass the three general tests (on lending, providing services, and investing) or choose evaluation using a strategic plan. Institutions that do not provide residential mortgage credit, credit to small businesses including farms, or retail consumer credit are subject to a community development test unless they choose evaluation using a strategic plan.

The test for small institutions is aimed at lightening their paper burden; it applies to institutions that have total assets of less than US$ 250 million and are independent or affiliated with a holding company with assets of less than US$ 1 billion. This test is based on a credit-to-deposits ratio, percentage of credit extended in the geographic area, client income level, client business size, geographic location of credit extended, and response to relevant complaints made under the *CRA*.

The community development test is applied to wholesale or limited-purpose financial institutions so designated with the approval of the appropriate regulatory agency. This test is based on credit extended, investments made, and community development services provided inside and outside given geographic areas.

Financial institutions may choose evaluation using a strategic plan; strategic plans must be approved by the appropriate regulatory agencies. A regulatory agency has 60 days in which to consider a financial institution's application to choose this option, taking into account public participation and measurable objectives in the proposed strategic plan; if the regulatory agency does not respond within 60 days, the strategic plan is deemed to be approved.

CONCLUSION: TRANSITION AND THE FUTURE

Implementation of the new regulations accompanying the CRA was phased in over 18 months, from 1 January 1996 to 1 July 1997, in order to allow the regulatory agencies to adjust to the requirements for evaluating the performances of financial institutions of different sizes and to gather data on credit extended to small businesses by major banks. At the end of the implementation period, the new performance evaluation standards and tests came into effect for all lending institutions.

Despite the amendments made since 1995, which would seem to lighten the paper burden and use more performance-oriented criteria, traditional differences of opinion persist between pro-free market lending institutions and those advocating government action to ensure fair lending.

In an effort to standardize the requirements and the presentation of evaluations by the regulatory agencies under the CRA, the Federal Financial Institutions Examination Council (FFIEC) analyzed CRA data for 1996, a year during which the amendments were being implemented. The FFIEC reported that the nature of the data available limited analysis and added that geographic information was not always accurate because locations where businesses obtained credit were not always those in which they did business, (that is, those where the credit was likely to be used). The Council also noted that the collated data contained no indications of local credit applications and thus limited analysis of data on credit extended.

The CRA is one of a series of legislative measures and programs aimed at promoting fair lending and community development. It provides specific tools and promotes greater use of the discretionary powers of the regulatory agencies in evaluating credit extended, particularly in less advantaged neighbourhoods. The new regulations will likely create a secondary, partially government-supported, credit market that will finance community development through increased investment and partnerships between traditional and community development financial institutions.

Developments in Internet banking may offer new options for extending traditional geographic limits to allow a better match between credit supply and demand. These developments will also allow CRA regulatory agencies to ensure that data based on geographic areas are accurate and meaningful.