The Community Reinvestment Act - History, Effect and Future

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Abstract

Research has been done to figure out the connection The Community Reinvestment Act (CRA) has with banks and communities. The CRA's history and effects have been recognized and acknowledged in this paper to find out if the CRA is necessary, useful, and/or if there are notable connections between it and the future of banking. After reviewing many papers and data surrounding banking practices in relation to the CRA and understanding the reasoning behind the CRA and its implementation, our team came to a conclusion to the necessity of the CRA. This paper found that the CRA has actively improved the relationships banks have with their communities and that it helps foster new financial resources for these communities, though current CRA regulations leave something to be desired when it comes to clarification and simplicity.

Keywords: The Community Reinvestment Act (CRA), Debt Management Plan (DMP), Relationship Banking

The Community Reinvestment Act: History, Effect and Future

Where Did CRA Come From?

The US Federal Mortgage Disclosure Act of 1975 was created to support communities and their investment initiatives through government sponsorships. Unfortunately, though, some banks at the time continued to deny support to certain communities. The residents of Low-Moderate income (LMI) communities believed that these banks were actively discriminating against them because of their race. The African American, Hispanic, and immigrant groups saw the banks as unfair, but many believed that it was in the bank’s rights, as many banks didn’t want to work with certain communities because of the relative income surrounding the communities and the relative risks perceived. The injustice caused by this separation between the banks and the people led to unrest, and many people rose up as figures for the people. A community activist named Gale Cincotta born on December 18, 1929 in Chicago, Illinois and died on August 15, 2001, had enough with the Home Mortgage Disclosure Act and the way bank continued to treat impoverish communities, and decided it was time for a change. Cincotta led the nation’s fight for new legislation that would help out communities in need. Through her leadership, Cincotta was able to get the Community Reinvestment Act of 1970 to be past, created a new way for these communities to get the banking rights they deserved. The Community Reinvestment Act of 1970 (CRA), created on October 12, 1977, was a law that was intended to encourage depository institutions, like savings banks, commercial banks, and savings associations, to help meet the credit needs of the communities in which they operated, especially in low-moderate income neighborhoods and businesses. We believe that the Community Reinvestment Act must help all low- to moderate-income households, communities and small businesses develop mutually beneficial banking relationships.

The 95th Congress of The United States originally passed CRA as an act, but President Jimmy Carter turned it into a law because people kept demanding it be given more importance. The Federal Reserve System (FRS), The Federal Deposit Insurance Corporation (FDIC), and The Office of the Comptroller of the Currency (OCC) were given the responsibility of making sure banks followed and respected the requirements of the CRA. The OCC also “Assesses a national bank's record of helping to meet the credit needs of its entire community” and “Considers that record in evaluating a bank's application for new branches, relocation of an existing branch, mergers and consolidations, and other corporate activities” (Office of the Comptroller Of the Currency, 2020), while also hosting exams for banks every two-three years. These exams, usually conducted by an OCC, FRS, or FDIC agent, review a banks and how it has interacted with its assessment area. These tests usually include facts, data, and analysis of the banking operations to come to a conclusion. After an exam, the agent issues a performance rating for the bank ranging from Outstanding, Satisfactory, Needs to Improve, and Substantial Noncompliance. These results determine if banks are allowed to operate in a normal fashion, like whether they are allowed to expand, move, or merge, and all banking evaluations are open to the public.

For the future of the CRA, we look towards the federal agencies that regulate banks. These agencies are the ones that determine what qualifies as a CRA loan and what specification I has to reach. The future of the CRA is determined by these agencies and any changes they decide to implement. One of the four agencies has already decided to update their regulations. this change will create a distinction between different banks and their regulators. The future of the CRA is uncertain but always changing.

Why Does CRA Exist?

Before the Community Reinvestment Act was enacted in 1977, banks were legally allowed to have biases against LMI neighborhoods. There weren’t any regulations prohibiting this kind of discriminatory behavior and many banks maintained the idea that this was the best business move for a company. Banks prohibited interaction with certain areas by either not opening any stores in these communities or by denying all requests for loans for people in these communities. Redlining, describe by the OCC as, “the practice whereby lending institutions refused to offer home loans in certain neighborhoods, based on the income, racial or ethnic composition of the area” (OCC), ran rampant. As described by the OCC, redlining as an act of discrimination has caused poorer, more helpless communities to be treated unfairly compared to their wealthier, whiter counterparts because of inherent biases prevalent in the banking business. An example of this discrimination can be seen in a study done by Gale Cincotta at Northwestern University in Chicago. This study concluded, “Hispanic residents of the Logan Square neighborhood had to rely on high down-payment FHA loans while mostly white residents of an adjacent neighborhood received low down payment conventional loans” (Silver, 2019). After enough protesting, though, Senator Proxmire, Chairman of the Senate Banking, Housing, and Urban Affairs Committee, decided to pass the Home Mortgage Disclosure Act (HMDA). The act required certain financial institutions to report their mortgage data to the public. This new act was meant to stop discrimination, but the act wasn’t effective as many banks simply continued their practices while also sending their record to the public. The over encompassing effects of these discriminations could now readily be seen. It had become obvious that more legislation had to be implemented if any noticeable change was to happen.

Two years later, Senator Proxmire conducted three hearings, starting on March 23, 1977. His opening statement declared the necessity to have a new, improved system. He brought up four main points, each made to establish the necessity of certain aspects of what they needed to do. “The government cannot and should not revitalize cities with its own resources; Financial institutions are the main source of capital for economic development in cities and rural areas; Financial institutions do not need to engage in risky lending to serve communities, and can often do so with relatively little risk because of their first-hand knowledge of communities; a public charter bestows economic benefits and ‘in return, it is legitimate for public policy and regulatory practice to require some public purpose, without the need for costly subsidies, or mandatory quotas, or a bureaucratic credit allocation scheme.’” (Silver, 2019) under these four premises the new system, or the CRA was it would become, would provide the framework for LMI neighborhoods, small businesses, and banks to build healthy banking relationships. The entire purpose of the CRA is to ensure connections between banks and its consumers aren’t challenged or cut, and the CRA helped develop new opportunities for those who needed it, for example it ensured banks acknowledge all communities, including the low-to-moderate income areas. In 1995 the federal bank agency implemented a test that banks would have to take to prove if they were following the Community Reinvestment Act’s measures. Banks are tested on their record of helping to meet the needs of its entire community. However, banks of different size levels are judged with different criteria. (OCC, 2014) For instance, large banks are tested more frequently and have the most comprehensive exams. While smaller banks are not required to be tested as often and test on their lending performance. One would think that because of the implementation of the CRA, the LMI borrowing rate would be rising yet, the share of mortgages to LMI borrowers from 2010-2016 seems to be on a steady decline as seen in Table 1. An update to the

CRA is necessary for LMI communities and small business to thrive. Banks still have the option of removing branches from LMI locations while still meeting CRA requirements. The idea of the CRA is helpful, while this may be true, the LMI borrowing rate is depleting at a rapid rate.

Table 1

Share of Mortgages to LMI Borrowers

Year	Largest 3 banks	Other Banks	Nonbanks
2010	32.40%	35.90%	38.10%
2011	31.50%	33.60%	36.90%
2012	28.40%	32.30%	35.70%
2013	22.10%	27.40%	30.10%
2014	18.80%	26.30%	28.40%
2015	17.40%	27.10%	29.60%
2016	14.80%	25.30%	27.60%

Note. Reprinted from "The Decline in Lending to Lower-Income Borrowers by the Biggest Banks", by Bhutta, N., Laufer, S., & Ringo, D. 2017, September 28. Retrieved from https://www.federalreserve.gov/econres/notes/feds-notes/the-decline-in-lending-to-lower-income borrowers-by-the-biggest-banks-20170928.htm

[a] The nonbank category excludes lenders identified as subsidiaries or affiliates of depository institutions.

What Real Impact Has the CRA Had Since It Was Created?

Although the community reinvestment act still has trouble with clarification and communication when it comes to testing banks, its effectiveness can still be readily seen in how it has impacted the economic ability of different income communities and how it has helped to resolve banking discrimination towards those same communities.

Before the 1970s, banks had full reign over loans. This meant that they could choose exactly who would receive loans and how costly these loans were. Because of the divisive climate of the past, especially during the civil rights movement, this freedom to serve only those the banks wanted to led to banks actively discriminating against certain communities. These communities of low- and moderate-income peoples and of minority groups were routinely looked over and not allowed the ability to get loans. During the 1970s, however, the government noticed the lack in connection between banks and these communities and decided to act in an attempt to remedy this. The government created many new laws and regulations that ensued banks were no longer allowed to discriminate against these communities. One of these laws was the CRA. The CRA helped end this discrimination by giving new incentives for banks to operate in these communities. These new incentives effected both the banking world and the consumers it benefitted.

The CRA made it so that any banks that did not connect with any low to moderate income communities faced large and immediate limitations on all aspects of banking. As the years went on, these new laws changed the banking landscape. The effect of CRA can most easily be seen in current day bank operation. When discussing CRA effectiveness, its easy to see how banks no longer redline, or actively go against certain communities. When asked about the effectiveness the current CRA has on modern day banking, Melissa Slover, the director of community engagement and CRA specialist, said, "Currently I do think the CRA is effective. I think that banks in general would self police and ensure they are working with the low and moderate income areas, but I don't know how well they'd self police. It allows the banks to put resources in areas that might not have been viewed as profitable in the past" (Slover). When discussing whether banks should determine who they should work with, Melissa encourages readers to understand the benefits banks get from having a separate system to work with and how the assurance of no discrimination from the CRA also gives these previously discriminated communities peace of mind. The CRA’s impact allows for both the banking customers and owners to benefit from expanded consumption.

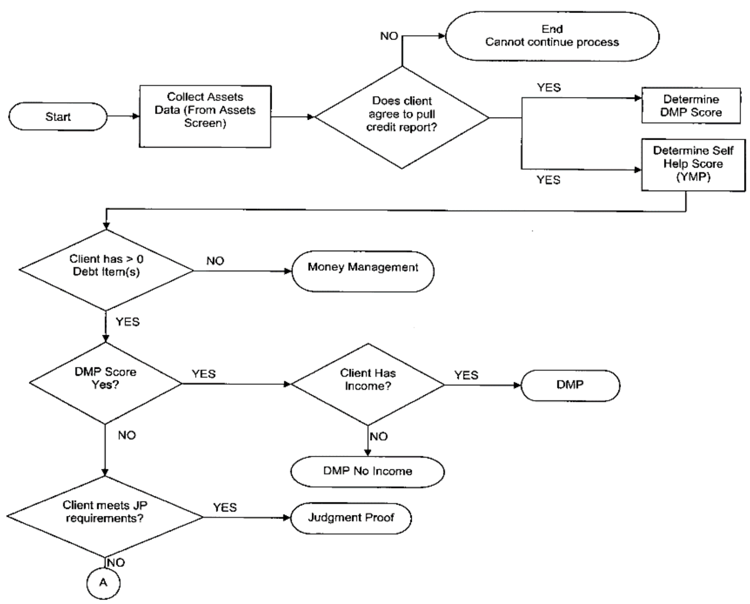
This greatly decreased discrimination also lends itself to another beneficial effect of the CRA, increased communication. When banks aren’t allowed to discriminate, they allow themselves to open and accommodate more people. With these new customers, more loans can be given out, and more incentives for new relations between customers and banks are made. Communication also comes in the connection between banks and the government. While this connection may not be beneficial to banks directly, it does allow the government to help regulate and improve aspects of banking. Also, with CRA representatives in each bank, banks can have an expert on what loans do and don’t qualify for the CRA tests and if they might need to change something to better accommodate CRA regulations. These new connections, only possible because of the CRA and other similar laws connecting banks and people, help strengthen these communities and grow new relationships with banks.

Future

When talking about solutions to the community reinvestment act, it’s hard to understand what that entails. The CRA does its job and helps people with their banking relationships, but it is not an end all be all that can save people from all their bad mistakes. In the 2008/9 recession, many communities were hit hard, and loans hit very large lows. But, CRA still comes into effect. Even during the recession, the CRA was still being implemented to help the people and the banks, but it couldn’t solve all the problems. People were still losing their jobs, losing money, and facing a crisis, all while CRA was actively working and helping people with banking troubles. When looking for a solution, us as a team more looked for ways of improvement instead of completely change. The solutions we devised were new implementations and policy changes that emphasizes maintaining relations with customers and protecting banks from money lose. These new systems helped people in debt not lose any more money so that banks have more reliability in their loans, and called for some modernization of the current CRA regulations. figure 1, as our first change, would connect people closer with banks and also help ensure people facing debt and bankruptcy had an easier way to manage money. This new system would slow customer decline and help against money loss from bankruptcy.

Figure 1

Debt Management Plan (DPM) Patent



Note. Reprinted from "U.S. Patent Application No. 12/080,422" by Celano, M. 2009. Retrieved from https://patents.google.com/patent/US20090048957A1/en

For the residents of low- to moderate income- neighborhoods and banks to develop mutually beneficial relationships, they need to begin strong relationship banking programs.

According to Investopedia (2020) "Relationship banking is a strategy used by banks to offer a variety of different products, strengthen customer loyalty, and generate additional revenue." Most banks use relationship banking as a way for customers to continue doing business with them. They also target specific demographics like college students and seniors by offering special-edition credit cards and loans. The same can be done for LMI communities by offering financial counseling and setting up a Debt Management Plan (DMP). Matthew Celano proposes an invention that allows a customer to obtain financial counseling automatically. This would allow the client to have the option of in-person counseling or going through an automated system without actually having to meet someone in person (U.S. Patent Application No. 12/080,422, 2009). Figure 1 shows the process of collecting data from the client. A Self Help Score if the client has debt or not, and if the client has a steady income is all taken into account. If the client has no debt, they are moved to a money management plan. If the client happens to be in debt then the DMP process is started. These assessments help the client determine the best course of action to take to remove their debt and/or stay out of it. Now banks would be a place where people who have debt won't be afraid of.

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