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Taking A Second Look At CRA

By Phil Hall

Ever since the current financial crisis began with the meltdown of the subprime mortgage market in 2007, a number of people have tried to assign the blame for the situation on legislation that went into effect three decades earlier: The Community Reinvestment Act (CRA) of 1977. But is CRA deserving of the blame for what transpired? Furthermore, is CRA still relevant in today's economic environment?

Robert Rowe, vice president and senior counsel at the American Bankers Association's Center for Regulatory Compliance, believes the repeated assertion of CRA's instigator role in the crisis has taken on a life of its own.

"It is becoming an urban legend," he says. "The heads of all of the banking agencies have categorically said no - that CRA had nothing to do with the housing crisis."

"CRA got caught in the crosshairs of the polemics of the [2008] election campaign," observes Judy Kennedy, CEO of the National Association of Affordable Housing Lenders (NAAHL). "Now, we know that CRA was not responsible, in any way, for the meltdown - but the polemics tarnished the brand, and the lies continue."

Jordan Brown, CEO of MarketWise Advisors LLC, Ponte Vedra Beach, Fla., concurs. "We're talking about 32 years of history," he says, with a laugh. "CRA did not require financial institutions to make high-risk loans or to jeopardize the safety and soundness of the corporation. It was designed to level the playing field and encourage institutions where they were taking deposits to even their lending across their geographic base."

Brown adds that CRA has shouldered a great deal of the blame because of the demographics of the community development lending.

"Subprime loans were made in the low-income neighborhoods, which also qualified for CRA," he says. "But there was not necessarily a causal relationship. CRA is a regulatory guard against redlining. Subprime lending had relaxed underwriting based on property appraisals and the lack of scrutiny to underlying credit quality, and it included exotic loans and the turning of B-, C- and D-paper into A-paper."

Even one of CRA's most vocal critics - Yaron Brook, managing director of San Jose, Calif.-based BH Equity Research and president and executive director of the Ayn Rand Institute in Irvine, Calif. - is able to cut the legislation a degree of slack.

"CRA had some role in the crisis, but not a major role," he says. "It played some role at the margin by encouraging banks to make loans to people in areas where they wouldn't otherwise be made. But when CRA enforcement dramatically ratcheted up in the 1990s, banks set up operations to satisfy CRA provisions. Those were aimed to satisfy regulators and were not anchored in the economics of profits and losses."

Brook adds that political undercurrents in regard to mortgage origination pushed CRA into rocky shoals. "There was a clear indication that Congress and both Clinton and Bush administrations' idea was that we should help low-income borrowers gain homeownership, irrespective of economic situation," he continues. "That encouraged nonprime lending all over the spectrum, with mortgages that were once called creative products but are now called destructive products."

Michael L. Larssen, president of Larssen Consulting in Clearwater, Fla., echoes Brook's observation. "The act was intended to remove discriminatory lending practices, enhance low-income neighborhoods and prevent redlining issues," he says. "But that barrier was crossed once specified costs were put on the agencies created by the government - when Fannie Mae and Freddie Mac had housing goals of having to produce 50 percent to 60 percent of their business in affordable housing. Those goals contributed to part of the problem."

Beyond what took place, there is also the question of what is happening now in regard to the housing market and the financial services industry. This raises a new question of what role CRA plays in today's lending environment.

"As long as CRA is judiciously implemented and carefully applied with an understanding of all the imperatives facing financial institutions, it can be useful to serve communities," says Ken Markison, associate vice president and regulatory counsel for the Mortgage Bankers Association.

"Yes, it is certainly a good piece of legislation," adds Rowe. "The red tape can be a headache. But, overall, most bankers feel it is worth it."

An effort is under way to expand CRA. The CRA Modernization Act of 2009, introduced in March by Rep. Eddie Bernice Johnson, D-Texas, would expand the existing legislation to include areas where banks conduct their lending through brokers - the current version of CRA only evaluates lending where banks have a physical branch or office. The new legislation would also expand CRA to nonbank financial institutions, including independent mortgage lenders.

Daniel W. Immergluck, associate professor in the City and Regional Planning Program at Georgia Institute of Technology in Atlanta, believes an expanded CRA could be warranted, particularly in view of recent events.

"We can argue there is both a greater need for it in the next few years and bigger justification for it, given the bailouts to the financial services industry," he says, adding that the expansion of CRA would be important to ensure the federal funds go to the communities that require additional assistance.

However, Markison does not support expanding CRA to nonbanks. "We don't have CRA for nondepositories," he says. "We think it doesn't seem applicable, considering its purposes, and we don't know how it would be implemented if it were applied to them."

Yet, Elizabeth Eurgubian, regulatory counsel for the Independent Community Bankers of America, is in favor of casting the CRA net wider.

"A lot of the problematic loans were made by non-CRA lenders, such as mortgage lenders," she says, adding that these nondepositories should be subject to CRA standards. "All financial service institutions should be covered evenly."

Eurgubian adds that one deposit-accepting sector has never been subject to CRA, and that it should also be included. "Credit unions, like banks, should prove they are meeting the needs of the communities they serve," she says. "We've urged Congress to apply CRA standards to credit unions."

NAAHL's Kennedy notes the example of Massachusetts, which put the same level of CRA-style regulatory oversight on credit unions and independent mortgage originators. Kennedy points out that the emphasis on safety and soundness in community development lending enabled the Bay State to avoid a higher degree of recession meltdown, particularly in regard to residential lending.

"Those laws helped Massachusetts avoid a lot of the foreclosures that plagued other states," she says.

However, Cliff Rosenthal, president of the Federation of Community Development Credit Unions, is opposed to this idea. "Credit unions are already doing a great deal of what CRA aims for in serving low- and moderate-income people," he says. "In this area, credit unions do more than banks."

Rosenthal adds that larger banks have successfully partnered with community development credit unions in meeting their CRA requirements, with the banks making deposits at the credit unions that, in turn, are used in financing residential lending and other community development programs.

"We can be a very helpful bridge to low- and moderate-income communities," says Rosenthal.

Ginna Green, a spokesperson for the Center for Responsible Lending, notes that the proposed Consumer Financial Protection Agency (CFPA) could go further than CRA in regard to enforcing community development lending, including residential home loan originations.

"We certainly need to make sure all communities have access to sound capital and credit," she says. "The progression of CFPA is a possible way to improve capital and credit access - it would be an overarching agency that would cover all financial institutions and products. We shouldn't close the door on CRA, but there are other options available."

However, Brook argues that expanding CRA is bad for business. "We need to focus on economic growth, including increasing the health of banks," he says. "We don't need lending based on non-bottom-line criteria."

Yet Brook acknowledges that in one form or another, CRA is here to stay. "The chances of Congress removing CRA are basically zero," he says.

*(Please address all comments regarding this article to Phil Hall, editor of **Secondary Marketing Executive**, at hallp@sme-online.com.)*