

What's Next for the CRA?

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Debate Rages Over Carter-Era Measure to Promote Low-Income and Minority Homeownership

By [Martha C. White](#) 1/18/10 6:00 AM

An ambitious plan to update the Carter-era Community Reinvestment Act that supporters hope to see signed into law in 2010 comes amid charges that this legislation was responsible for nothing less than the subprime crisis and the resulting collapse of the residential real estate market. The plan, sponsored by Rep. Eddie Johnson (D-Tex.), would close some loopholes in the original act that let non-bank financial firms operate with relative impunity. It would levy negative ratings on a much wider array of institutions that practiced predatory or discriminatory lending, and it would require that non-bank entities like mortgage providers and insurance companies comply with all CRA tenets.

Why this piece of legislation is still such a lightning rod more than 30 years after its introduction is something both its supporters and detractors struggle to explain from their respective camps. "The idea that this was just some sort of carrot-stick regulation that didn't work is a perception that goes very much in hand with a right-wing agenda," said Jose Garcia, associate director for research and policy at advocacy group Demos. Demos is one of several progressive groups seeking to have the bill, the Community Reinvestment Modernization Act of 2009, made into law. On the other hand, Mark Calabria, director of financial regulation studies at the Cato Institute, asserts that political pressure drives CRA support. "It fundamentally gets to some very emotional issues. [Supporters] see this as an issue of racism and social justice," he said. The Cato Institute held a forum in November that was broadly critical of the CRA, asserting that the financial models at its core are faulty. Federal Reserve chairman Benjamin Bernanke called the CRA a "catalyst" in 2007, although he touched on the trouble already brewing in the subprime mortgage sector as an imperative to revisit the Act in the wake of significant changes in the banking industry since its implementation. At its heart, the CRA was created to try and legislate out some of the institutional discrimination in the financial services industry. It was conceived in a very different era from today's world of global banking behemoths. In the wake of the civil rights movement, most banks were still small, often single-branch operations. Many would operate selectively in low-income and minority neighborhoods, accepting the deposits of local residents but only writing home or business loans in more affluent communities. Regulatory changes in banking

plus an agenda embraced by Fannie Mae and Freddie Mac to boost homeownership cracked the mortgage market wide open beginning in the 1990s, and the CRA was initially credited with higher rates of homeownership among low-income and minority Americans. According to Kathleen Day, spokesperson for the Center for Responsible Lending, “The purpose of the CRA is to go into underserved areas and look for credit-worthy borrowers you overlooked because of red-lining,” she said, referring to the bank practice of categorically refusing to lend in certain neighborhoods. The result of reckless lending practices is by now apparent to everyone, although concerns were swept under the rug in the go-go years of the mid 2000s. CRA supporters say brokers and non-bank mortgage outfits wrote nearly 95 percent of the bad loans, while the Act took the fall when these loans turned out to be unsustainable.

“Nine out of 10 of the people who got bad loans already had homes,” said the Center’s Day. “Six out of the 10 were refinances and three were selling one home and buying another.” Often, Day adds, the unscrupulous vendors that preyed on subprime mortgage candidates cloaked their malfeasance in the language of the CRA’s mission, a sleight of hand that muddied the waters and assigned undue blame on the regulation when mortgages — and the huge numbers of securities backed by them — began to sour.

Even Lawrence White, a New York University who wants to see the CRA scrapped, says it’s not to blame for the financial meltdown. “The CRA has very little to do with the subprime lending debacle,” he said. Aside from mortgage lending, the other goal of the CRA is to provide basic banking services to low income and minority citizens. In these locations, “Pawnshops and the like literally became the banking services,” said John Taylor, president and CEO of the National Community Reinvestment Coalition, the organization spearheading the modernization of the CRA.

“In some communities there are no financial institutions,” asserted Demos’s Jose Garcia. Geographic impediments and language barriers create a two-tier system that leaves low-income Americans, minorities and immigrants without access to the banking and lending services the middle class takes for granted.

If the legislation were better-enforced — something the NCRC’s Taylor believes the modernization bill would facilitate — banks wouldn’t be able to do things like close branches in these communities without repercussions. But preventing closures would just be the beginning. In a 12-page statement, the NCRC spelled out major features of modernization. Key among them are inclusion of non-bank financial firms under the umbrella of CRA oversight, and a greater emphasis on the neighborhoods in which institutions write loans, not just the locations where their branches or offices are located. This is partially due to the rise of online and branchless financial institutions, but Taylor says the switch will also prevent companies like subprime mortgage-peddlers from operating under the radar.

Advocates also want to see enforcement of the CRA transferred to the not-yet-created Consumer Financial Protection Agency. The CFPA, as its supporters envision it, would consolidate regulatory oversight and enforcement of banking and lending activities in a

single agency, rather than the patchwork of regulators some say let ruinous business practices slip through the cracks. The modernization effort isn't without roadblocks, though. The current House bill has yet to progress to the Senate, although Taylor says the NCRC's goal is to have the modernization signed into law sometime this year. The CFPA doesn't even exist yet, and might never come to fruition. Last week, Senate Banking Committee Chair Christopher Dodd (D-Conn.), the lawmaker who has championed the idea, indicated he may be willing to abandon the idea of a consumer protection agency.

In the end, it's not clear what is ahead for the CRA. Some, like the Cato Institute's Mark Calabria, think the need has run its course. "There was a logical *raison d'être* for the creation of the CRA at the time but that justification is no longer there," he said. He admits that an outright repeal of the Act is unlikely, though. NYU's Lawrence White also wants to get rid of the CRA, although he wants to replace it with a cap-and-trade system of credits similar to the protocol used to eliminate acid rain-causing sulfur dioxide in the 1980s. Progressive and social-justice groups say that the CRA, while not perfect, needs to be improved, not thrown out. "We're talking about trillions of dollars of private resources that could be available to low and moderate-income neighborhoods," said the NCRC's Taylor. "We believe in banks. If we don't have them active in these neighborhoods, it's very unlikely they're going to prosper. We want banks to see these neighborhoods as an important part of the economic future of this country and of their business plans." In the end, it might come down to that. If the notoriously profit-hungry banking industry sees economic potential in lower-income areas, this would go a long way towards keeping the predatory players out of the arena.