The Community Reinvestment Act: Past, Present, Future

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Origins of the CRA

- Paucity of lending in lower-income and minority communities owes to many factors
  - Legacy of racial discrimination
  - Regulatory restrictions
    - Interest rate ceilings deter risk-based lending; branching and acquisitions restrictions limit competition in banking
  - Market failures (information problems)
    - Difficulties in quantifying risk
    - Information barriers heightened by lack of national credit reporting system
    - First-mover problem
  - Secondary market focused on prime or FHA/VA loans

Changing Market Circumstances

- Consumer regulations enacted and enforced
  - CRA encourages lending and coordination
  - HMDA sheds light on home lending practices
  - Enhanced fair lending enforcement
- Deregulation of banking and lending
  - Geographic branching and acquisition restrictions eased;
  - Risk-based pricing emerges as rate ceilings preempted
- Emergence of national credit reporting system
- Robust secondary market with appetite for risk
- Lenders gain experience in underwriting and managing risks of lending to lower-income individuals and areas
  - New products, coordinated activities, enhanced servicing,

Democratization of Credit

(Any debt)

Proportion of Households with Any Debt

Income Quintile	1977	2004	Percent Change
Lowest	45	53	18
Second	64	70	9
Third	79	84	6
Fourth	85	87	2
Highest	87	89	2

Source: Surveys of Consumer Finances, Federal Reserve Board

Democratization of Credit

(Mortgage debt)

Proportion of Households with Mortgage Debt

Income Quintile	1977	2004	Percent Change
Lowest	12	16	33
Second	22	30	36
Third	38	52	37
Fourth	58	66	14
Highest	69	76	10

Source: Surveys of Consumer Finances, Federal Reserve Board

Research on the Effects of CRA

- Profitability and performance (surveys of lenders)
  - CRA-related lending at least somewhat profitable and did not usually have disproportionately higher defaults
- Neighborhood effects (threshold or margin analysis)
  - Higher-homeownership rates, higher growth in owner-occupied homes, lower vacancy rate
- CRA and access to credit
  - Need to measure ***marginal*** contribution of CRA
  - Estimates suggest relatively small, but positive effect
  - CRA-regulated lenders have larger shares of their lending to CRA-eligible borrowers in assessment areas than noncovered lenders or out of market lending by covered lenders

Effects of CRA (CONTINUED)

- CRA impose costs on covered lenders not borne by competitors
  - Small business and small farm lending data reporting
  - Compliance costs
- May raise efficiency concerns as each covered institution is judged on their own merits across each of the performance criteria but specialization may offer best market outcomes
- Unintended consequences as credit may be made to borrowers who are not able to manage their debts or on prices or terms that are not commensurate with the risks or costs they pose

Issues Going Forward

- Who should be covered? Growing share of lending by noncovered lenders and covered lenders outside their local communities
- Is the concept of a local CRA assessment area still relevant?
- Pricing and terms and conditions on loans have taken on more prominence now than access to credit—is more lending always better?
- More emphasis on a broader range of services and more flexible credit products
  - Products to encourage savings and use of deposit services
  - Products to compete with payday lending and check cashers