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The Community Reinvestment Act: Reimagined

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The Community Reinvestment Act: Reimagined

Thesis Submitted to Levy Economics Institute of Bard College

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Annandale-on-Hudson, New York May 2022

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ABSTRACT

America has long been considered the land of opportunity. However, the American Dream's attainability has not been widespread. Instead, wealth continues to be funneled into the hands of the select few.

In an effort to combat income inequality and to provide capital reinvestment for historically left behind groups, Congress enacted the Community Reinvestment Act (CRA) in 1977. The idea behind the legislation was to stimulate lending and extend credit to areas that were affected by redlining, classism, or other prejudicial practices that enabled income inequality. This thesis aims to analyze the legislation to understand both the strengths and weaknesses of the CRA. It will also provide recommendations on how to build upon the strengths of the bill and how to eliminate the shortcomings.

The analysis will also explore how the US financial system could facilitate equitable outcomes.

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Introduction

Inequality is rampant, the Coronavirus Pandemic not only escalated it, but also opened Americans' eyes to what has been occurring over the past 250 years. Americans are enamored by the idea of the "American Dream." However, this dream is more of a façade. A power dynamic between those at the top and those at the bottom has existed since the United States was founded and affects many aspects of American life. For example, the justice system and labor market show consistent signs of prejudice. According to an article published by the Federal Reserve Bank of St. Louis, white households account for 85% of total household wealth but account for just 66% of households, while Black families own 3% of total household wealth yet only account for 15% of households (Kent and Ricketts 2020). Those with financials resources have been able to improve their socioeconomic standing, while those who lack these important means have been left out. Credit plays a major role in American life. In a capitalist economy like the one in the United States, adequate finances may not always be available when making purchases. Instead, credit can be provided to aid in the purchase of goods and services. Consumers and businesses alike, require credit to go about their daily lives. However, it has long been noted, and evident in the previous statistic, that access to credit is not universal. Up until the passing of several bills in the latter portion of the twentieth century, the institutions and practices that promoted this unacceptable behavior were protected under law.

In 1977, Congress passed the Community Reinvestment Act (CRA). The bill was enacted along with two others during the same decade that were aimed at creating a more equitable financial playing field. The Home Mortgage Disclosure Act of 1974, and the Equal Credit Opportunity Act of 1974, sought to eliminate discriminatory practices in the housing and credit markets, specifically redlining. Redlining, or the designation of areas investment potential based upon race, ethnicity, or other demographical factors, was legal in the United States up until the 1970s. Redlining initially came about following the Great Depression. As part of President Franklin Delano Roosevelt's New Deal, the Home Owner's Loan Corporation (HOLC) surveyed the largest 239 cities in the country and assessed their candidacy as potential areas for investments. The neighborhoods were graded on a scale ranging from A to D in accordance with their perceived credit risk (Krimmel 2020). While on the surface it may seem as though redlining was conducted to make financial institutions safer and less risky following

the world's worst financial crisis, the practice became a way for the HOLC to discriminate based upon factors that had nothing to do with the ability to pay back a loan. "Less favorable" investment areas became synonymous with neighborhoods with high minority populations, low average incomes, and renters while "more favorable" investment areas contained a vast majority of white individuals, existing wealth, and homeowners. Prior to the enactment of the CRA, discriminatory lending practices like redlining were legal and rampant.

For almost half a century, until the end of redlining in the 1970s, the HOLC completed neighborhood surveys that selectively targeted "investment-deserving" populations. This practice resulted in fostering an unequal financial landscape that limited development in communities. The effects of redlining are well documented. In a sample of 51 cities, Krimmel found, "86 percent of African Americans lived in a redlined neighborhood in 1940, despite the fact that blacks constituted only 8 percent of the (sample) population. By contrast, only one in three whites (35 percent) lived in redlined areas despite making up over 90 percent of the 1940 sample population" (Krimmel 2020). The research shows the skewed racial makeup of areas deemed more and less favorable for investment. What was disguised as a safety measure for financial institutions was actually a weapon used to maintain the divide between the haves and the have-nots, laying the foundation for persistent economic inequality. Credit-worthiness became dependent not on the merits of an individual's financial capabilities, but on the location of the potential borrower. In addition, segregation was legal in 1940 meaning neighborhoods were very homogeneous. The lack of diversity in neighborhoods during this time made it easy to distinguish between predominately white neighborhoods and predominately black which then allowed for HOLC regulators to easily exclude those in the latter areas from being deemed worthy of credit. Over time, redlining would become a harmful tactic used by the US financial system to exclude credit access to so many individuals. Krimmel's research proves this sentiment. From 1940-1970, housing supply in neighborhoods that were graded as credit-favored increased 16 percent, while housing supply in redlined neighborhoods saw did not change significantly. During the same time period, redlined neighborhoods saw a 22 percent differential decline population (Krimmel 2020). Although the practice was outlawed as a result of the aforementioned legislature, the effects are still being felt today. The systematic exclusionary nature of the US financial system has disregarded countless Americans. Redlining is a prime example of what divisive financial practices can do and how time does not necessarily heal all wounds.

The Community Reinvestment Act attempts to hold financial institutions responsible for better satisfying the credit needs of the communities in which they serve. Banks, in their most basic description, serve as gatekeepers of funds. They take deposits and make loans. Since banks are private entities, they can decide where they want to engage in the collection of deposits and the underwriting of loans. Thus, areas could be deposit-rich and offer banks a low cost of funds, while simultaneously not reaping the benefits of banks investing in them via loan underwriting. This phenomenon is known as disinvestment as areas are providing capital for banks, yet banks are not reciprocating in providing credit for the community. Redlining made it easy for banks to get away with this as they could justify their loan origination patterns by the perceived credit-worthiness of the areas in which they served. The CRA aimed to ensure that banks did not single out areas and neighborhoods as "deposit-only" areas. Put more simply, Congress wanted banks to hold up their end of the bargain. While discriminatory lending and redlining allowed for this to occur, a shift occurred with the Civil Rights Movement of the 1960s and the political landscape was beginning to put more emphasis on racial equality. Recognizing the importance of financial capabilities, Congress began to pass legislation aimed at overhauling the previously racist and biased practices that dominated the space at the time. The CRA aimed to do away with discriminatory lending practices and to prod banks into expanding credit. Specifically, the CRA encourages banks to lend to LMI neighborhoods, though these neighborhoods were often predominately populated with individuals of color. It was through this act that the US financial system attempted to become more equal.

History of the CRA

Congress thought long and hard about how to handle extending credit availability to historically left behind areas. Even today, some question why there are no formal thresholds that banks must reach to be in compliance with the CRA. It is no accident the bill does not contain concrete benchmarks. During the drafting of the bill, some politicians did favor including lending quotas. However, it was the ideas of those like Senator Robert B. Morgan, a North Carolina Democrat, that prevailed. Morgan was skeptical of the CRA in general, but especially to the idea of lending quotas. If successful, he believed the CRA would succeed in allocating credit to those previously excluded, but if it failed, it would only discourage inner-city lending (Ludwig, Kamihachi, and Toh 2009). If quotas were not set at optimal, credit-extending levels,

banks would be in compliance with the CRA while simultaneously making no strides to impact the communities they serve. Weary of how banks would respond to the new legislation, Congress took out the lending quotas from the bill, which allowed for extreme flexibility for banks and regulators alike to self-determine if the credit needs of the areas they served were being met. In addition, lawmakers feared that CRA implementation could potentially disrupt the financial system. Since the areas in need of credit were previously deemed "undesirable" by redlining practices, there was concern that banks may opt to forgo lending standards in order to comply with the CRA. Stopping the potential problem before it started, Congress included the language that "CRA lending should be consistent with the safe and sound operation of such institution" (Ludwig, Kamihachi, and Toh 2009). Lawmakers recognized the precariousness of the situation if the CRA was written haphazardly. Therefore, closing any potentially dangerous pitfalls was essential to the success of the bill.

Congress has amended the CRA numerous times in the past. The first of these alterations came in 1989. The passing of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) required regulatory agencies to make their CRA evaluations and ratings available to the public (Ludwig, Kamihachi, and Toh 2009). This move was essential for three main reasons. First, FIRREA further standardized the CRA ratings scale into a four-tier system: Outstanding, Satisfactory, Needs to Improve, and Substantial Noncompliance. After the change, more financial institutions earned below-average ratings, reflecting the fact that regulators were becoming more demanding in their evaluations (Ludwig, Kamihachi, and Toh 2009). The legislation also allowed for community coalitions to aid in the process of ensuring local credit needs were met, giving community members a role in the implementation of the CRA. The role of local community groups, which will be discussed later in this thesis, is crucial to the goals of the CRA. By giving community members a role in CRA implementation, banks could be held to higher standards. With the public release of CRA evaluations and ratings, local coalitions could have a better idea of how successful banks were in writing loans, supplying investment, and providing financial services to those in need. It is important to remember that while this was certainly a step in the right direction, access to ratings and evaluations is the bare minimum. More action would be needed to better equip local coalitions to help banks extend credit. Finally, the 1989 legislation was vital in that it provided some teeth to the bill. A bank's public image can affect how people think about it. In turn, this could potentially alter share prices and even chase business away. Publicly disclosing bank's

CRA evaluations and ratings helped make the bill more transparent. But this only. Future alterations would be needed to continue to increase transparency.

Transparency was included in the 1989 amendment but was limited to making public the CRA evaluations and ratings of banks. The passing of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) built upon this foundation. This bill extended the information regulators' information disclosure to include "publication of both the data and factual findings used to support the rating assigned to an institution" (Ludwig, Kamihachi, and Toh 2009). In a similar way to the FIRREA, the FDICIA increased the tools available to delve into banks' abilities to fulfill CRA obligations. Local coalitions were able to more accurately determine if a bank was meeting local credit needs. These groups also gained a better understanding on how banks were being evaluated on their CRA requirements. This furthered the discourse surrounding meeting LMI credit needs as there was nowhere for financial institutions to hide.

Soon after the passing of these bills, two more bills were enacted that intrinsically modified the eligible banking activities under the CRA: the Resolution Trust Corporation Refinancing, Restructuring and Improve Act of 1991 (RTCRRIA) and Housing and Community Development Act of 1992 (HCDA). The RTCRRIA allowed banks to earn CRA credit for providing loans to minority-owned banks, women-owned banks or low-income credit unions, as long as the loans benefited the local community (Ludwig, Kamihachi, and Toh 2009). The dynamics of the American financial system heavily favored individuals with a history of good socioeconomic standing, who were usually white men. Expanding CRA-eligible credit to activities that spurred growth in forgotten firms and businesses reimagined the scope of the CRA. The HCDA stipulated that operating a bank branch in predominately minority areas, or to minority- or women-owned banks should be viewed in a positive light when CRA examinations are being administered. The logic behind this move was that minority- and women-owned institutions were presumed to be more likely to lend to LMI neighborhoods. Thus, the HCDA provided more of an indirect effect on CRA lending while the RTCRRIA provide a more direct effect.

The next amendment to the CRA came in the form of the passing of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (RNIBBEA). In order to address disinvestment, the bill required regulators to conduct separate CRA examinations for each state in which a financial institution operated (Ludwig, Kamihachi, and Toh 2009). In order to

dissuade banks from raising deposits in one presumably less economically advantaged state in order to increase lending volume in another more economically advantaged state, the bill required state by state CRA examinations. Prior to acquisition of a bank branch, the purchasing bank would need to earn at least a Satisfactory rating on their CRA examination. This gave the larger, purchasing banks the incentive to engage in CRA-eligible activities to ensure their ability to grow their business in other states. Since the enactment of this bill, many banks have branched out and thus the incentives provided have decreased in effectiveness through time. Still, the RNIBBEA sought to nudge larger banks into abiding by CRA standards to continue their paths to growth.

The Gramm-Leech-Biley Act of 1999 (GLBA) provided another advancement in CRA legislation. The bill is usually associated with the repealing of the Glass Steagall Act of 1933, however, it had important implications for the CRA as well. The legislations established the requirement that banking firms and their subsidiaries as well as national banks must earn and maintain a Satisfactory CRA rating in order to conduct additional financial activities (Ludwig, Kamihachi, and Toh 2009). The GLBA allowed for the remarriage of commercial banking and investment banking activities, legalizing the operations in the securities business. Since then, banks commonly operate in the securities business whether that be in the form of buying, selling, or issuing securities. The GLBA added strength to the CRA by setting a standard on examinations in order for banks to engage in such activities.

The largest modifications to the CRA were made during the Clinton Administration. Recognizing the subjective nature of CRA examinations, President Clinton tasked regulators with reforming the bill and tightening up loose ends. Several authors argue that: "Prior to 1995, CRA examiners assessed performance on the basis of 12 factors and then rated institutions on a five-point scale, where 1 was the highest possible grade and 5 the lowest. These ratings were opaque and subjective. For instance, the Federal Home Loan Bank, the former thrift regulator, considered a ranking of 3 to be Satisfactory while the three other federal bank regulators required a rating of 2 for a bank's CRA performance to be considered adequate" (Ludwig, Kamihachi, and Toh 2009). Standardizing rankings between regulating agencies was paramount if the CRA was to become more objective. Government officials were not the only ones to complain about the CRA's lack of concrete rankings. Community activists and financial institutions also supported changes to help better understand CRA compliance. In 1994 the Office of the Comptroller of the Currency spearheaded an effort to obtain information from the

public, community coalitions, financial institutions, and other financial players regarding the CRA's effectiveness and compile suggestions for improvements. As a result, the examinations of the CRA were modified in April of 1995 and included the size and business model of the institution into account. Institutions would be "evaluated within its Performance Context, which reflects the institution's characteristics, including its products and business model, its peers, its competitors, its market, and the economic and demographic features of its assessment areas" (Ludwig, Kamihachi, and Toh 2009). In addition, average CRA ratings dropped as regulators became more scrupulous when conducting exams. Slowly but surely, the legislative changes to the CRA began to increase its transparency and with that, allowed for the bill to affect change as it was meant to do.

Format of the CRA Exam

The CRA examination is comprised of three separate tests: the lending test, the investment test, and the service test. The lending test examines how banks lend. The number of loans and volume of loans produced are key factors in this test as well as the type of loan (mortgage, small business, small farm, consumer, etc.). In addition, regulators also take geographic and income distribution into account. Generally speaking, for a loan to qualify for CRA eligibility it must be originated either for a LMI individual or for a LMI business in a bank's self-defined assessment area. Qualified activities are not limited to primary market lending, or directly underwriting loans of customers. Purchasing loans in the secondary market (buying previously originated loans), will also qualify for CRA eligibility. The investment test measures the level of community development investment projects. Andrew Nold of the St. Louis Fed describes the primary purpose of the projects:

> affordable housing (including multifamily rental housing) for low- or moderate-income (LMI) individuals; community services targeted to LMI individuals; activities that promote economic development by financing businesses or farms that meet the size eligibility standards as outlined under the CRA; and activities that revitalize or stabilize LMI geographies, designated disaster areas, and distressed or underserved nonmetropolitan middle-income geographies. (Nold 2019)

The final aspect of the CRA examination is the service test. This test looks into the accessibility of banks branches and low-cost checking accounts in the established assessment areas. The service test examines whether a bank is performing its most simple function for its customers:

providing customers with a safe home for their money. While the three tests are crucial parts of the CRA examination, each does not carry the same weight.

As previously stated, the ratings of CRA tests range from outstanding, satisfactory, needs to improve and substantial noncompliance. The satisfactory rating is also divided into high satisfactory and low satisfactory. For the investment and service tests, the points allocated to each rating are 6, 4, 3, 1, and 0. However, for the lending test, the points allocated to each rating are 12, 9, 6, 3, and 0 (Getter 2015). This larger weight applied to the results of the lending test showcase its heightened importance. The main function of the CRA is to encourage financial institutions to extend credit in areas in which they accept deposits regardless of socio-economic status. Therefore, one would expect that lending, the most direct way to impact credit availability, should have the greatest impact. When it comes rate primary lending market versus secondary lending market, the scoring system is less intuitive:

> …a bank may receive CRA consideration under the lending test for making a loan to LMI individuals that is guaranteed by a federal agency, such as the Federal Home Administration (FHA). If, however, a bank purchases securities backed by pools of FHA-guaranteed mortgage originations, this activity receives credit under the investment test. Thus, the bank receives less CRA credit than it would for making a direct loan even though it would still be facilitating lending to LMI borrowers. (Getter 2015).

Since providing the loan is more direct than purchasing securities backed by said loan, the bank would be eligible for CRA credit under the heavily weighted lending test rather than the investment test. The scores from each test are summed in order to obtain the overall CRA composite rating. A bank is required to accumulate 20 or more points to earn an Outstanding rating, 11-19 points to earn a Satisfactory rating, 5-10 points to earn a Needs to Improve Rating, and 0-4 points to earn a Substantial Noncompliance rating (Getter 2015). Each test plays a role in determining the Composite CRA Rating, but none more important than the lending test.

There are additional stipulations regarding how banks are examined. For example, the size of the bank plays a pivotal role in how regulators view CRA compliance. In 2005 regulators divided banks into "small", "intermediate small", and "large" banks. The most recent Federal Reserve definitions state that "Small" banks have assets less than $1.384 Billion, "intermediate small" banks have assets greater than $346 Million and less than $1.384 Billion, and "large" banks have assets in excess of $1.384 Billion. (Board of Federal Reserve Governors, 2021). These are important distinctions as regulators only assess the lending test when determining CRA compliance with small banks. Small banks do not have the same resources as large banks

both in terms of the capital at their disposal and in terms of the physical infrastructure. This is used as justification for why large banks have additional responsibilities regarding the CRA. Banks do not have the same capacity to address credit complications, the size designation in the CRA accounts for this variability.

The Community Reinvestment Act was enacted to improve credit availability to those economically disadvantaged, including those who were victims of discriminatory lending practices such as redlining. Congress was meticulous in drafting the bill. However, like everything, the CRA is not perfect and has been subject to various alterations since its enactment. The disclosure of CRA data and ratings, the expansion of CRA-eligible activities, and the requirement that financial institutions maintain a “Satisfactory” rating in order to participate in the financial activities stipulated in the Gramm-Leech-Biley Act of 1999 are all examples of some of the impactful changes of the bill. Chapter 1 will delve into how although the CRA is not perfect, there are numerous strengths, and with them, outcomes, that have positively benefited American society.

Chapter 1

The CRA is a bill with numerous strengths that showcase real, identifiable positive change for a society aiming to be more inclusive and cognizant of the harm and unfair aspects of persistent inequality. Congress sought to follow suit and improve the drastically biased financial space in hopes of extending credit and financial services to those who have been banned from receiving the benefits. There exists evidence to support the notion that the CRA has accomplished this goal to some degree by motivating banks to extend credit to LMI neighborhoods. Prior to the enactment of the CRA, banks legally used redlining, or selectively decide which areas were worthy of loan production regardless of deposit base. Thus, banks were completely within their rights to receive low-cost funds (deposits) and offer limited loan production. While the banks reaped the benefits, the neighborhoods were seeing minimal improvements in their financial well-being. Since the CRA was enacted, redlining was outlawed and the consequences were visible. Chapter 1 will analyze if the CRA has been successful in accomplishing the goal of creating a more equitable financial playing field.

Small Business Lending

The ultimate goal of the CRA is to encourage banks to lend to LMI neighborhoods. Prior to the enactment of the CRA, small business loan production in these communities was dwarfed compared to more affluent ones. Research shows that since the bill's inception, banks have made a conscious effort to improve upon this. In doing so, a more equitable financial playing field has become a reality.

Bostic and Lee show the increase in small business loan production in their 2017 paper. Their quantitative work observes small business lending patterns using data from 1996 to 2015. The researchers split this time frame into 3 smaller periods: 1996 to 2002, 2003 to 2011, and 2012 to 2015. The year 1996 was chosen as the starting point because, in the year prior, the CRA was heavily reformed. With respect to being in an CRA-eligible census tract, the researchers found that for the sample as whole, there is a small, but significant, positive relationships in small business loan volume of originations and dollar amount. CRA-eligibility was associated with 1.368 additional small business loans and an additional $157,284 in small business loan volume per LMI tract (Bostic and Lee 2017). Thus, it can be concluded that the

CRA has indeed motivated banks to alter their lending patterns to comply with the bill. However, when this is broken down further, it is discovered that during 1996 to 2002 and 2012 to 2015 these relationships are positive while during the 2003 to 2011 period it was negative. Figure 1 showcases this trend. Although the yearly data is not statistically significant, the trends in the graphs show a general positive relationship during 1996 to 2002 and 2012 to 2015 and a negative relationship during 2003 to 2011. One possible explanation for the negative correlation in the middle period is the effects of the 2008 financial crisis. A credit crunch ensued and access to financing was limited. It should be noted that even during one of the most daunting of financial episodes in recent memory, the data still shows promising signs for the CRA's ability to alter the decision making of financial institutions. As the authors put it, "The positive relationships observed in the 1996-to-2002 period support the view that the CRA has influenced the distribution of small business credit, as does the relationship in the 2012-to-2014 period" (Bostic and Lee 2017). It can be inferred from these results that during times of economic prosperity, banks respond positively to CRA incentives. While these results are certainly promising, more is needed to be done to solidify the claim that the CRA has positively affected small business lending. The following evidence will support this claim and establish a strength of the bill.

Kim, Lee, and Earle complement the work done by Bostic and Lee by doing a comparison of CRA credit-eligible census tracts and non CRA credit-eligible census tracts. The research proposes that if the CRA is effective in encouraging banks to underwrite small business loans to LMI neighborhoods, statistics should show that gaining CRA-eligibility increases originations. The work of these authors show the importance of the CRA in small business lending in LMI neighborhoods. Their model is as follows: $LOAN_{it} = \alpha_i + \theta_t + \beta * CRA_{it} + \delta * D_i \rho_{it} + f(MFI_{it}) + \epsilon_{it}$ where $LOAN_{it}$ is the log number or amount of small business loans for tract i in year t, α_i are tract fixed effects, θ_t are year fixed effects, CRA_{it} is an indicator for CRA eligibility, D_i is a dummy for tracts that become eligible, ρ_{it} is a linear even-time trend, and $f(MFI_{it})$ is a function of the MFI (median family income) ratio (Kim, Lee, and Earle 2021). In addition, the authors separate the data into bandwidths of 100 percent (all tracts with an *MFI* ratio $\geq .8$), 20 percent ($.8 \leq MFI < 1.0$), 10 percent ($.8 \leq MFI < .9$) and 5 percent ($.8 \leq MFI < .85$). In controlling for each dependent variable, specification (*MFI*, *CRA***MFI*, *MFI* squared, and *CRA***MFI* squared, and bandwidth, the coefficients estimates were all positive. Areas that fall within the 10 and 5 percent bandwidths see a 3-7 percent increase in the number of small

business loans and an 8-10 percent increase in the volume of small business loans (Kim, Lee, and Earle 2021). The results support the idea that small business loan production is increased in assessment areas that gain CRA eligibility. This shows that financial institutions are motivated to increase their loan production in areas that become eligible for CRA credit.

The researchers also uncovered another interesting trend regarding the timing of eligibility. When examining the data for possibility of lags, it was discovered that the effects of gaining CRA eligibility grow stronger over time with regards to small business loan production. The results in Figure 2 showcase this trend. The estimated difference between tracts that gain CRA eligibility and those that do not in each time period is statistically insignificant prior to the change in eligibility, and statistically significant and positive once the newly eligible tracts are added (Kim, Lee, and Earle 2021). This, though somewhat expected as bankers become more comfortable with lending to areas they are already accustomed to doing business in, shows that the CRA not only makes an instant impact on small business lending but that this impact grows over time. The importance of the CRA for small business lending in LMI neighborhoods can be seen through the work of these authors.

Kim, Lee, and Earle's research closely resembles the earlier work of Ding, Lee, and Bostic. A stark difference is that while the former observed the effects of gaining CRA-eligibility, the latter observed the effects of both gaining and losing CRA eligibility. Ding, Lee, and Bostic observed the effects of a policy change in 2014 in which census tracts were reassessed for CRA-eligibility and thus copious changes were made. This allowed for them to observe the effects of gaining and losing CRA eligibility on small business loan production. The model used by the authors is as follows:

> $Y_{it} = \beta_0 + \beta_1 * TREAT_i + \beta_2 * POST_t + \beta_3 * TREAT_i * POST_t + y * N_i + \epsilon_{it}$ where Y_{it} is the value of the outcome measure Y (the number and dollar amount of small business lending) for tract i in year t. $TREAT_i$ represents whether tract i is one that became newly eligible or ineligible after 2014; the variable is ultimately omitted in the estimation because we include tract fixed effects. $POST_i$ is a dummy variable assigned a value of one for the post-2014 period. $TREAT_i*POST_t$ is the two-way interaction of the time and treatment dummies. The coefficient of the two-way interaction term β_3 is expected to capture the CRA's effect on outcome measure Y. N_i represents the fixed effect of tract i, which helps control for tract-level unobserved heterogeneity (Din, Lee, and Bostic 2018).

The effects of gaining CRA eligibility, while positive, are not significant. Similar to the previous study, a reason for this could be bankers' comfort level to newly CRA-eligible tracts. However, newly CRA-ineligible tracts saw a significant decrease in both the number of small

business loan originations and volume of originations. Specifically, tracts that became ineligible "saw an average decline of 3.3 small business loans per tract-year in the post 2014 period and a decrease of 2.4 loan originations to smaller firms" (Ding, Lee, and Bostic 2018). Their data shows that without CRA eligibility, banks immediately became less inclined to lend in these neighborhoods. Though the effects appear to be less severe for smaller firms, these are also firms who are also more likely to require financing. Regardless, an immediate decline in loan originations ensues. While losing CRA eligibility may imply an improving economic landscape as the designation is no longer necessary, it is also associated with an immediate decrease in small business loan production. The instant change in bank lending patterns showcases the CRA's innate ability to affect financial institution decision making. CRA eligibility is clearly a motivating factor behind lending patterns.

Work by Chakraborty, Chhaochharia, Hai, and Vasta conveys a similar message. Their study also focuses on small business lending but differs in a few key ways. Like the previously mentioned authors, these researchers also used census tract reclassification as a tool to observe changes in lending. However, because of their large sample of data, they went a step further to isolate the effects of the CRA and looked at the changes in the proportion of LMI neighborhood populations. Taking into account county and year fixed effects they compared it with the mean change in the entire sample and the overall LMI neighborhood's small business loan growth. The authors estimate that 35.88 percent of the increase in LMI small business loan growth can be attributed to the CRA through census tract reclassification (Chakraborty, Chhaochharia, Hai, and Vasta 2021). To arrive at this calculation the authors multiplied the coefficient associated with the change in the fraction of newly classified LMI census tracts within a county by the mean change in the fraction of newly classified LMI census tracts within a county divided by the average increase in small business lending in LMI tracts. The authors then take this analysis a step further in asserting that this number then translates to a total of $20.45 Billion worth of LMI small business loans being originated by financial institutions due to the implementation of the CRA (Chakraborty, Chhaochharia, Hai, and Vasta, 2021). This number was calculated using the previous percentage of small business loan growth due to the CRA multiplied by the volume of small business lending in LMI communities. While the previous researchers have been able to show the effects of the CRA has had on small business lending, Chakraborty, Chhaochharia, Hai, and Vasta were able to take the idea to the next degree and provide estimates for just how

impactful this legislation has been. The CRA's impact on small business lending in LMI cannot be ignored and the conclusions drawn from the data confirms this.

Taken altogether, the effects of the CRA can be seen on small business lending. The work of Bostic and Lee showcased the overall increase in small business loan underwriting in LMI neighborhoods since the 1995 reforms. Kim, Lee, and Earle's research exemplified the effects of the CRA in spurring banks' investments into small business loans of LMI neighborhoods. Ding, Lee and Bostic then showed bankers' responsiveness to neighborhoods that lost CRA eligibility. The overall increase in small business loan production in the targeted neighborhoods, the positive effects seen with becoming CRA-eligible, and the negative effects of becoming CRA-ineligible all point to is the ability of the CRA to alter how banks conduct small business lending, a strength that cannot be overstated.

Mortgage Lending

The CRA aimed to extend credit to historically forgotten individuals. The legislation has been successful in encouraging financial institutions to increase small business loan production in the targeted LMI areas. In addition to small business loan production, the bill seeks to increase credit availability for those attempting to purchase mortgages. As previously stated in the introduction, the CRA was part of a group of bills, along with both the Home Mortgage Disclosure Act and the Equal Credit Opportunity Act, aimed at addressing the inequities present in the American financial space. Similar to small business lending, mortgage lending has also been altered due to the CRA.

As has already been discussed, redlining and other exclusionary baking practices made credit less accessible to those in LMI neighborhoods. The CRA has made an impact in extending access to credit, not only in regards to small business lending, but mortgage lending as well. Daniel Ringo, of the Federal Reserve Board, exhibits this idea through the use of a model in which a tract is added to a bank's CRA assessment area. The rationale for the model was to show the effects of the Office of Management and Budget altering MSA boundaries in 2003. In doing so, banks' responsiveness to changes in CRA assessment areas could be measured. The logic behind Ringo's model is that if the CRA is effective in eliciting changes in mortgage loan production by banks, the results will show that as LMI tracts are added to banks' assessment areas, mortgage lending will increase as the bank is motivated to meet CRA

obligations and extend credit to individuals in these communities. The results from this study solidify that claim:

> The estimated elasticity of LMI lending to the number of banks newly assessed in a tract as a result of the MSA redefinitions is about 0.1, and statistically significant at the 5 percent level. With an average of 5.5 assessed banks per tract in the estimation sample, these results suggest incorporating a typical tract into one additional bank's assessment area would increase mortgage lending there approximately 2 percent (Ringo 2017).

The data shows the swift action taken by banks in response to adding a tract to their assessment areas. The addition of CRA-eligible tract, increases mortgage loan production. This shows the efficacy of the bill with modifications to increase mortgage lending and supports the idea that the CRA is successful in encouraging banks to lend in LMI neighborhoods.

Though the addition of a CRA eligible tract into a bank's assessment area provides evidence for the success of the bill in regards to spurring mortgage loan production in LMI neighborhoods, another avenue of evidence lies in the effects of gaining and losing CRA eligibility. Similar to the Ding, Lee and Bostic in the previous section, Ding and Nakamura set out to observe the effects of gaining and losing CRA eligibility, only this time the focus was mortgage lending. Specifically, Ding and Nakamura decide to look at the Philadelphia metropolitan division (MD) and the surrounding counties, (Montgomery, Bucks, and Chester which will be referred to as "MBC") after the massive overhaul in tract eligibility which occurred in 2014. Roughly one in six of all tracts that experienced a change in CRA eligibility status were in the Philadelphia MD (Ding and Nakamura 2017). This made the Philadelphia mortgage market an obvious choice to observe the effects of changing CRA status. In doing so, the researchers discovered results consistent with the theme of CRA success. More specifically, they found that with respect to the control group, newly ineligible CRA tracts in the Philadelphia MD experienced a decrease of 2.26 purchase applications, 11.9 percent of the 2013 mean, and a decline of 1.67 purchase originations, 9.8 percent of the 2013 mean, by CRA-regulated financial institutions (Ding and Nakamura 2017). The results for gaining CRA eligibility were less conclusive. According to the descriptive statistics of their research, Ding and Nakamura show that newly eligible tracts in the MBC counties experienced increased applications and originations, .5 percent increase and 5.4 percent increase respectively, but that these results were insignificant (Ding and Nakamura 2017). Similar to the small business lending findings of Ding, Lee, and Bostic, the mortgage lending findings of Ding and Nakamura find that losing CRA eligibility causes banks to significantly reduce their production, but

gaining CRA eligibility proves to be insignificant immediately after the policy shock alters tract designation. The influence of the CRA is demonstrated in the immediate decrease in mortgage loan production. The study further supports the idea that the CRA has been effective in altering the behavior financial institutions in regards to their mortgage loan production.

The two papers presented in this section arrive at the same conclusion: the CRA has had an impact on the mortgage lending decisions of banks. Ringo displayed that adding a tract to a financial institution's CRA assessment area coincided with an increase in the supply of mortgage loans, suggesting that banks are responsive to changes in their CRA responsibilities. Ding and Nakamura showed that the effects of losing CRA eligibility were met with significant decreases in mortgage loan applications and originations. Taken together, these two papers showcase the ability of the CRA to affects change in mortgage loan production by depository institutions.

Bank Branching Patterns

The first two successes of the CRA have centered two major types of products offered by banks: small business loans and mortgage loans. These two areas fall under the heavily-weighted lending test. However, financial institutions have responded positively to not only lending incentives, but also to service incentives. The scoring criteria in the service test consists of "availability of branches and low-cost checking in the assessment area" (Getter, 2015). In a similar way to its success regarding small business and mortgage loan incentives, the CRA has also shown promise in its ability to support the nurturing of bank branches which allows these entities to stimulate greater credit access.

Though the service test constitutes a smaller portion of a financial institution's CRA composite rating than the lending test, it remains an important facet. Physical bank branches are paramount to creating an inclusive credit environment. The CRA has been instrumental in motivating banks to keep branches open. Ding and Reid showcase this in their study. The regression they used suggests that being located in a LMI neighborhood in a bank's CRA assessment area is associated with a lower risk of branch closure. Specifically, the authors find that branches located in CRA-eligible LMI tracts within the 70-90 percent of median family income (MFI) range are associated with a reduction of .21 percentage points in probability of closure while similar branches located within the 75-85 percent of MFI are associated with a

reduction of .32 percentage points in probability of closure (Ding and Reid 2019). Though these numbers may not seem noteworthy, consider the fact that the annual closure rate in the study was 2.3 percent. A reduction of .21 percent and .32 percent constitute 9.2 percent and 14.2 percent of the annual closure rate. The data showcases the strong effect the CRA has on bank branch health. Banks with branches in LMI neighborhood are incentivized to keep them operating as they serve as key access points to credit and help improve CRA ratings. To further this point, the authors run another set of regressions divided by income range and concerned with the net loss of branches per 10,000 residents per year. They used LMI neighborhood status as a coefficient. Their findings here suggest continued success of the CRA. In particular, the LMI coefficients for number of branch closures were negative for all four population groups with an average coefficient of -.0093 (Ding and Reid 2019). This means that the number of branch closures per 10,000 residents is .93% less likely in a LMI tract. Status as a CRA-covered tract is linked to less bank closures. The regression also posed interesting results for branch openings. The results of the coeficients for number of branch openings per 10,000 residents were largely positive with an average of .047. While these results are insignificant, a larger data pool could potentially confirm these initial results and suggest the CRA is more influential than initially considered. The authors also ran a regression that divided tracts by the number of branches within. In doing so, their results show that the effects of the CRA are more prominent in tracts with only 1 branch. The coefficient for branch closure probability in tracts with 1 branch was -.005 and significant whereas it was only -.0015 and -.0012 for 2-3 and 4 branches respectively. Banks respond more drastically when branches are more important to their communities. As Ding and Reid put it, “This suggests that CRA exams serve their intended purpose: During a bank’s CRA exam, regulators pay attention to whether a proposed branch closure in the neighborhood would result in a banking desert and often require banks to provide additional justification to ensure that the closure is warranted on the basis of the bank’s safety and soundness” (Ding and Reid, 2017). While the statistics do not immediately jump out, after further consideration the positive effects of the CRA on bank branch health can be seen.

Bank branch health is crucial to the functioning of the US financial system. With greater access to banking services, more individuals are able to participate actively in the economic world. History shows that access to banking services is not widespread. The implementation of the CRA has encouraged and motivated banks to be more responsiveness to the credit needs of

their communities. In a similar way, banks have benefitted from their importance in these neighborhoods. As a result, bank branch health has benefitted from the externalities of the CRA.

Chapter 2

The previous chapter displayed where the CRA has been successful in its aim to radically improve inclusion in the financial sphere. Small business loan production, mortgage loan production and bank branch health have benefitted as a result of the CRA. In turn, access to credit has been expanded and the American financial system has moved towards becoming more equitable. But the legacy of the CRA cannot be judged solely on its strengths. Like any bill, it has its weaknesses. The CRA has several facets that muddle its efficiency. This chapter will expose its flaws.

<u>Issues with the CRA Examination</u>

As stated in the introduction, the CRA Examination is composed of three separate tests: the lending test, investment test, and service test. The total scores are added up and an appropriate Composite Rating is assigned based on these values. While the investment and service test have a maximum of six possible points, the lending test has a maximum of twelve possible points. However, criteria do not exist that is associated with the various ratings. Getter describes this when he says, "Generally speaking, the number of points some CRA-eligible investments receive relative to others is up to the regulator's judgement given that no formal definition of "innovativeness" or "complexity" has been established" (Getter 2015). For example, while one regulator may believe a financial institution has earned a 6 on the lending test, another may believe the same institution has earned a 9. This three-point swing could potentially be the difference between earning a "Satisfactory" rating and a "Needs to Improve" rating. Consequently, the composite rating could then impact whether the financial institution is able to merge or acquire another bank. Without benchmarks, or even general ranges of benchmarks, regulators have a difficult time accurately determining if local credit needs have been met. This muddles the efficiency of the CRA Examination and impacts the effectiveness of the bill as a whole.

In addition to the actual Examination itself, the data that regulators use to provide their ratings is also flawed. Marijoan Bull conducted a case study of Holyoke, Massachusetts to observe the effectiveness of CRA information in regards to the roles community development corporations (CDC) play withing the scope of the CRA. Specifically, students at a local

university worked with local CDCs to determine the if the information used by the groups was adequate in determining if local credit needs, specifically community development activity, were met. Her research arrived at two startling conclusions: the data used lacked specificity and the performance evaluations on community development loans were far too general. The unsatisfactory data stemmed from issues with the assessment areas of the seven banks observed. Assessment areas area self-defined by banks and usually contain multiple MSAs and/or multiple towns, cities, or counties. This creates issues as the work of CDCs is on a much smaller scale. Because of the lack of specificity, determining banks' ability to meet local credit needs is difficult. As Bull writes, "Thus, in general, it is not possible to determine if the community development activity happened within census tracts 8114 or 8115, or even more generally within the city of Holyoke" (Bull 2017). The data being reported lacks the specificity needed to help CDCs address credit needs. CDCs require accurate data to help banks extend credit to communities that have historically not had the same financial opportunities as others. Community development projects are paramount to the success of development. In addition, they make up a massive portion of CRA eligible activities. With respect to what types of financial activity counts for CRA compliance Goodman, Zhu, and Walsh write, "We found that less than 27,000 community development loans, valued at $96 Billion, receive almost as much credit as the 3.5 million single-family loans for CRA compliance purposes" (Goodman, Zhu, and Walsh 2019). Community development loans are not just important for development as a whole, as their importance for CRA compliance cannot be overstated. Without accurate data on these activities, the jobs of CDCs become significantly more difficult. Through no fault of their own, these groups are then left to make decisions based upon assumptions rather than facts. This is detrimental to the effectiveness of the CRA and provides a roadblock in it achieving its purpose.

Community development information is not the only source of suboptimal data in the CRA Examinations. As this thesis has shown, small business lending is a vital part of community development and the CRA. One would then expect this type of data to be of the utmost quality. However, that is not the case in the slightest. Though small business data is paramount to the success of the bill, it suffers from the same lack of specificity as the community development data. Goodman, Zhu, and Walsh write, "Current small business data do not separate the different lending types (traditional versus credit card). In addition, the data could be more useful if they decomposed the credit card amount into the drawn and undrawn

amounts" (Goodman, Zhu, and Walsh 2019). Data is an essential element in the decision-making process. Yet, when it comes to small business lending, regulators and community financial activists are equipped with less-than-ideal tools. Not only are lending types not differentiated, but the amount drawn on small business credit cards is also not differentiated. This poses an issue as credit allocation can become distorted. For example, a small business credit card with a spending limit of $10,000 and low revolving utilization will appear identical to a $10,000 small business loan in the data pool. While these are similar financial products, there are stark differences. The former option could be used for very small payments over a short amount of time while the latter option could be used for a large purchase that needed to be made immediately. These are factors that affect how the investment by the bank into the small business could impact development and the community economy. In turn, the regulators' interpretation of how the financial institution is meeting the community credit needs is being distorted because of a lack of specific data. Like the unsatisfactory community development loan data, the small business data is also detrimental to the effectiveness of the CRA.

Like the previously mentioned authors, Carolina Reid also conducted a study on CRA data accuracy. What she uncovered combines the two more specific data entry inconsistencies. She writes, "In some cases, data for loans and investments were reported in tables, sometimes they were buried in narrative sentences, and sometimes they were missing altogether. We also found instances where the data within the PE (performance evaluation) were inconsistent from one section to the next (for example, two conflicting amounts reported for the same number of investments)" (Reid 2019). Not only is data collected suboptimal as it is far too general and lacks specificity, but the organization of it is less than ideal as well. Financial institutions are not placing a large enough emphasis on ensuring their data reporting is satisfactory. Reid is able to take this analysis a step further in showing that not only are lending metrics reported in a haphazard way, but investment data also suffer the same fate. This adds another layer to the ineffectiveness of the CRA Examination. Data is crucial to arriving at accurate and fair conclusions and in the absence of reliable and specific data, results are less reliable. The CRA requires the most updated and specific data so regulators can make sound judgements and community financial activists can assist banks in helping communities receive the credit they so desperately need.

As previously stated, banks are evaluated on their ability to meet the credit demands of their assessment areas. These assessment areas are self-defined. In addition, they are also rather

dynamic. A bank is allowed to alter its assessment area as long as it contains whole geographies and does not purposely exclude LMI neighborhoods. As Bull has alluded to, this creates massive issues when it comes to reporting CRA-eligible activities. The data suffers because of the inconsistencies in reporting and the issues that come with collecting and analyzing it. These are not the only issues associated with assessment areas however. While smaller banks may only possess one assessment area, larger ones may have hundreds, even thousands depending on their size. Larger banks are also much more likely to offer services over the internet. But what happens when a bank wants to underwrite what would be CRA-eligible loans in an assessment area other than its own using its online lending platform? The answer is unclear. Not only do assessment areas complications make CRA activities difficult to account for, but even more generally, the eligibility of lending and investment suffers from a lack of clarity. Susan Wachter's policy brief on the CRA goes into detail regarding the inefficiencies of the bill. She states, "Determinations about the eligibility of specific lending activities, especially with regard to community development, are inconsistent and non-transparent" (Wachter 2019). As banks become more confident and comfortable with CRA regulations, logically one would expect them to be more inclined to engage in CRA-eligible activity. The opposite can be said if this confidence is absent. Financial institutions are complex businesses that meticulously make choices on how to deploy their capital. Providing them with as much information and certainty in the CRA process will only help to encourage compliance with the bill. More must be done to ensure that financial institutions are able to research potential business opportunities so that CRA compliance becomes more streamlined and ultimately more effective.

The CRA examination is the core of the bill. The subjective nature of the exam renders allows for inconsistencies. The combination of these inconsistencies and a lack of specific data and accurate reporting, muddles the efficiency of the exam. Regulators and community coalitions become less effective in their quest to determine if credit needs are being met. At the same time, financial institutions' CRA compliance is hindered and the goal of the bill, to extend credit to LMI neighborhoods, is at risk of not being attained.

Organizational Shortcomings

The CRA's functioning is dependent upon three parties: financial institutions, financial regulators, and community financial activists. Together the Federal Deposit Insurance

Corporation (FDIC), the Federal Reserve Board (the Fed), and the Office of the Comptroller of Currency (OCC) make up the regulatory authority of the bill. Financial institutions are the target of the bill with regulators providing overview of the bill and community activists being a liaison between the communities in need of an improved credit environment and the financial institutions that serve them. As expected, the size and power of these financial institutions and community coalitions are not uniform. With all of these different moving parts, inefficiency can be expected. This section will bring to light some of these issues.

Each of the three major entities of the bill serve an important purpose. Financial institutions and regulators are required by law to participate in the CRA. But community financial activists' participation is not a legal obligation but a moral one that serves to improve the communities in which they live. The importance of these groups cannot be understated. Casey Farhat and Cartwright explore the role financial community coalitions play in their paper and their ultimate conclusion reinforces this idea. The authors conduct a case study of St. Louis, Missouri and observe the effects of the formation of a financial community activist group called the St. Louis Equal Housing and Community Reinvestment Alliance (SLEHCRA). As of 2017, the coalition contains over 25 organizations (Casey, Farhat and Cartwright, 2017). Some of the coalition's duties include analyzing local banks' participation in CRA activities, writing public letters to CRA regulators in an attempt to discuss issues with CRA evaluations and applications, and fosters dialogue and collaboration between banks and the communities they serve. To observe the effects of the forming of the coalition, the authors looked at two dependent variables, loan approval and type of lender. Specifically, the authors find that, "a significant, positive increase in the percentage of application approved in the post-CRA governance context emerges (80.02% in 2007-2010 and 89.91% in 2011-2014)…Likewise applications to lenders with CRA agreements are significantly higher in the post-CRA governance context (2.19% in 2007-2010 and 5.40% in 2011-2014)" (Casey, Farhat, and Cartwright, 2017). The effects are similar when the minority applicants are considered alone (an increase of 14.98% in the percentage of loans approved and 6.92% increase in applications to lenders with a CRA agreement). This research shows the positive impact community coalitions can have. Through their work, financial institutions and the communities they serve become more integrated and the credit environment improves. While these are certainly positive results and speak to the potential effectiveness of the bill, this is not a one-size-fits-all strategy. As Casey has shown in the past, community mobilization is not as prevalent in all communities. She writes, "In cities

that lacked extracommunity and public sector ties, CRA agreements were less likely to be negotiated. Therefore, while on one hand there may be value in the indirect elements of CRA regulation, the realization of the value may be contingent on the patterns of social capital present in a community" (Casey 2009). Without a strong community activist effort, the benefits associated with CRA designation are not realized as effectively. Yes, community coalitions are effective in eliciting positive CRA outcomes from financial institutions, but the responsibility should not fall so harshly on their shoulders. More must be done to complement their work in an effort to establish a more efficient CRA.

The responsibility among banks is also unevenly shared. The work of Chakraborty, Chhaochharia, Hai, and Vasta has been discussed in the context of the CRA increasing small business loan production. Their work also sheds light on which banks are contributing their capital. After previously showing that a change in LMI status results in an increase in small business lending, the authors found that after accounting for county and year fixed effects, large banks (>$50 Billion in assets) experience an 11.19 percent increase in credit supplied to LMI small businesses due to change in LMI status while small banks (<$10 Billion in assets) experience a 19.60 percent increase (Chakraborty, Chhaochharia, Hai, and Vasta, 2021). The results show that smaller banks are almost twice as responsive to CRA eligibility alterations when compared to larger banks. Another previously discussed paper shows a similar idea. Ludwig, Kamihachi, and Toh write, "In 2001, banks with less than $1 billion in assets held only 16.8 percent of bank and thrift assets, but they extended about 28.2 percent of all CRA loans and more than 47 percent of CRA farm loans" (Ludwig, Kamihachi, and Toh 2009). The responsibility of extending credit through measures taken by the CRA falls unevenly on the shoulders of smaller financial institutions. Larger banks have much greater capabilities yet they are not doing their fair share to invest in the communities they serve through CRA compliance. For the bill to achieve its goal, it requires a more even distribution of participation from financial institutions. The responsibility for meeting credit needs applies to all financial institutions, not just the smaller ones.

The rationale behind the implementation of the CRA is to improve the credit environment for those who have been historically left behind. This means taking the necessary steps to create a more equal financial landscape. This responsibility should be evenly distributed in order to streamline the process. Without such an allotment of accountability, inefficiencies will rear their ugly heads and act as roadblocks to the goal of the bill.

Lack of Power

Like all laws, there exist punishments and enforceable actions to motivate financial entities into complying with the law. Although extending credit to those who need it most is an immensely important mission, Congress did not feel that it warranted strict penalties for those who did not oblige. This section will briefly cover the specific aspects of the law that show a rather weak attempt at enforcement.

The penalties and teeth of the CRA are by all means insufficient. The law essentially has two avenues in which it can incentivize compliance. The first direct route being that federal regulators consider a financial institution's CRA performance when it is applying for either a merger, acquisition, or new branch with the second more indirect route being the public disclosure of loan-level data thanks to the Home Mortgage Disclosure Act which enables community coalitions to hold them accountable (Ding, Lee, Bostic, 2018). There are no fines for failing to earn a "Satisfactory" rating. Instead, institutions are given a slap on the wrist. In addition, not all banks require mergers or acquisitions to grow their assets. Smaller banks can grow loans and deposits. This means that if these banks do not earn satisfactory CRA ratings, they face no consequences. The optics on this weak penalty are horrifying. Financial institutions can go about their business as usual and completely disregard the CRA. An equally alarming fact is that almost all banks receive "Satisfactory" ratings to begin with. As Getter points out, "For all years (2006-2014), approximately 97% or more of banks examined received ratings of Satisfactory or Outstanding" (Getter 2015). While there is nothing wrong with a high percentage of banks passing, the income gap is widening in the US. If so many banks are doing such an incredible job complying with the CRA, why has income inequality never been worse? It has already been shown that financial institutions are receptive to CRA incentives and that these incentives spur increased credit access. The logical conclusion is that regulators evaluate banks with far too much leeway. The subjective nature of the performance evaluations is certainly a factor but the fact remains that banks area simply getting off too easy. The combination of inadequate penalties and a lenient enforcement policy prohibit the CRA from having the power it needs to accomplish its goals.

The CRA lacks adequate enforcement. Failure to abide by the standards of the CRA results in minimal penalties for financial institutions. The punishment for inadequately serving the credit needs of a community are designed to limit growth opportunities, yet there are ways

around this. To even arrive at these failures is rare as almost all financial institutions receive a "Satisfactory" rating. It is laughable how regulators evaluate financial institutions. Both penalties and standards need to be raised if the CRA is to accomplish its mission.

Chapter 3

The previous two chapters of thesis have sought to dive into the strengths and weaknesses of the CRA. The following chapter will complete this analysis by juxtaposing these positive and negative aspects of the law before arriving at a conclusion regarding its efficiency. Finally, suggestions will be offered as to how the CRA can be improved.

Evaluation of the CRA

Like every law in history, the CRA's legacy is one of mixed reviews. There are strengths of the bill and weaknesses of the bill. As far as strengths, the CRA has been able to encourage financial institutions to increase small business loan production and mortgage loan production in the targeted neighborhoods. In addition, the legislation has proved to be medicine-like in regards to bank branch health. As far as weaknesses, the CRA suffers from the various inadequacies associated with the CRA Examination, suboptimal organization and uneven distribution of responsibility, and a lack of power. Supporters and critics of the bill alike each have valid arguments to suggest that it has been both successful and unsuccessful. Though its flaws are evident, the CRA has been successful in its mission to expand credit to underserved communities. Simply put, since the inception of the law in the 1970s, small business and mortgage lending production in LMI neighborhoods has increased. These results may not show the strongest correlation between the implementation of the bill and increased lending but the point remains that a positive relationship exists. There is ample evidence to support this notion and this thesis introduces the research of a plethora of authors that do so. The data consistently shows that the CRA has indeed encouraged financial institutions to better equip the communities they serve with credit and financial services that are vital in this dynamic economy. Banks are making an effort to reach out to individuals who have been historically left behind by the discriminatory and elitist banking practices that had existed in the United States for so long. There is still much to be done. The aforementioned weaknesses of the CRA are undoubtedly muddling the efficiency of the bill and prohibiting it from reaching its full potential. The remainder of this thesis will address each weakness and suggest alterations in an attempt to strengthen the results and do more to truly attain an equal credit environment.

Recommendations on How to Improve the CRA

The CRA suffers from inadequacies associated with the performance evaluation, suboptimal organization and responsibility distribution, and a lack of strength in enforcement. These shortcomings cannot be eradicated with a single suggestion, rather this thesis will explore several options that could potentially lead to a massive impact in moving the CRA towards maximum efficiency.

One way in which the CRA's efficiency can be improved upon is with the formation of a federal CRA committee. This committee would include members from all three regulatory agencies as well as other financial regulators and banking experts. Their focus would be to evaluate the CRA annually to ensure that the law is accomplishing its mission. The committee would also conduct ongoing, regular dialogues with regulators, financial institutions, and community coalitions. The previous chapter shed light on the fact that financial institutions do not always know what counts for CRA activities. In addition, community financial activists play a large role in CRA implementation. Conversations between representatives from these groups and the proposed CRA committee will streamline the process of improving CRA efficiency. The 1995 reforms were groundbreaking for the success of the CRA. But there is no reason why the entities associated with the CRA need to wait for a request from the president to work on improving the bill. By establishing a committee dedicated to the law, the logistics of the bill can be continuously scrutinized which will lead to constant evolution of the CRA. The financial world needs to be more receptive of the everchanging economic conditions. Instituting a committee for the sole purpose of enhancing the CRA is a necessary step that needs to be taken in order to address the inadequacies of the past.

The committee's general responsibility will be to ensure that the CRA is running smoothly. This will obviously not be the only task of the committee. Another vital step that must be undertaken to improve the workings of the CRA is a widespread research expedition that helps to establish broad standards for the exam. As this thesis has explained, a core issue concerning the efficiency of the CRA stems from the unsatisfactory performance evaluations. Regulators have little structure and guidance when conducting these assessments and inconsistencies arise. These do not need to be overly-specific conclusions like "a ___% increase in small business lending in a LMI tract is associated with a ___% increase in the neighborhoods GDP/capita" but rather more general conclusions based upon high-performing

CRA institutions. For example, researchers could work to uncover which assessment areas have moved up from LMI status due to CRA activities undertaken by a local financial institution. Researchers could then use these examples as case studies for successful CRA implementation. In doing so, regulators could then create broad ranges of metrics associated with better CRA performance and neighborhoods' prosperity. This could range from assessing what types of lending products are most associated with long-term growth or which investments are the most beneficial for communities with regards to increasing participation in the financial sphere. In the simplest of terms, this research should serve as a large-scale dissection of what has made the CRA successful and then implementing these strategies to correspond to exam incentives. The CRA exam criteria will have to remain somewhat open-ended to provide regulators the opportunity to take into to account the infinite number of variables that affect financial institutions. However, this research should provide some much-needed consistency in the exam. Increasing the consistency and transparency of the CRA Exam is beneficial for all entities. Regulators will have an easier task in evaluating financial institutions, these institutions will be able to make better informed CRA decisions, financial activists will be better equipped to engage in CRA dialogue with local financial institutions, and communities will benefit from the increased attention paid to the CRA. In addition to overseeing the general operations of the CRA, the federal CRA committee should conduct periodic research to ensure that the bill is continuously being tailored to the ever-changing financial landscape.

A major shortcoming in CRA functionality is the lack of transparency and consistency in data. Another task of this committee can be to spearhead a data overhaul into a single CRA database that combines information from the various sources (HDMA, FFIEC CRA files, etc.). Authors like Bull, Goodman, Zhu, and Walsh, Reid, and Wachter all raise the same concern that CRA data is often incomplete, lacks specificity, or simply nonexistent. The suboptimal data creates issues for regulators attempting to provide financial institutions with consistent CRA Exam results. In addition, it creates obstacles for community coalitions to efficiently engage in dialogue with local bank branches since conclusions drawn from the data are not sufficiently accurate. Following this logic, it can be seen how it is ultimately the communities in need that suffer as their credit needs cannot be sufficiently attended to without accurate representations of financial institution's lending trends or productive conversations between said institutions and community coalitions. A central CRA database that compiles data from all CRA-related sources will help to quell inconsistencies and missing data. This database should also contain additional

criteria that the current, ineffective data sets ignore. Quality data is paramount to the success of the CRA and its importance cannot be overstated. In her brief regarding aimed at bringing the CRA up to date with the current financial landscape Wachter writes, "The first step toward a modern CRA is to improve data collection, in terms of both the consistency of reporting requirements and the specificity of the data required. This, in turn, must be supported by the development of a technological regime that will enable regulators and banks to analyze the more robust data to be collected" (Wachter 2019). Goodman, Zhu, and Walsh share a similar idea in saying, "Any CRA modernization effort should pay close attention to data collection, with an eye toward making it possible to evaluate which aspects of the CRA are impactful and which are not, allowing for further program improvement over time" (Goodman, Zhu, and Walsh 2019). A new and comprehensive database will provide a crucial initial step in CRA modernization. The CRA committee's ongoing task of ensuing maximum CRA efficiency through improving data collection will follow Goodman, Zhu, and Walsh's guidance of allowing for 'further program improvement over time'. Data collection and analysis are at the foundation of the CRA. Improving the quality of data is imperative if the CRA is to become more efficient and ultimately more impactful in helping communities attain access to credit and financial services.

The previous chapter mentioned a lack of legislative potency in regards to penalties for unsatisfactory CRA performance. As previously stated, almost all financial institutions receive a satisfactory or better on their CRA Exams. This spoke to the haphazardness of the ratings scale. However, taking this one step further, those financial institutions that failed their CRA Exams faced minimal consequences. The current penalties are merely a slap on the wrist. Increasing the punishment for a lack of CRA compliance will help to spur better CRA participation. One potential avenue to accomplish this could be the introduction of a fine for failing to meet CRA standards. Financial institutions are in the business of moving capital around the financial world. Hitting these important economic agents where they will feel it (their pockets) will serve as a wake-up call to better align their business models with a society aiming for greater financial equality and participation. These fines need not be crippling as to severely hurt the institution. But an additional fine based upon the size of the institution should incentivize bank executives to abide by CRA standards. Ludwig, Kamihachi, and Toh include an additional way for lawmakers to prod financial institutions into CRA compliance. They write "To provide a meaningful incentive for institutions to take the ratings seriously, Congress might consider

capping the percentage of executive salary and bonus that is tax deductible if a firm fails to maintain at least a Satisfactory CRA rating" (Ludwig, Kamihachi, and Toh, 2009). Financial players must recognize the importance of the CRA and adding negative consequences will help achieve this. Congress should think critically and creatively to ensure the heightened punishments will create meaningful changes to financial institution decision making. In addition to strengthening the negative reinforcements associated with the CRA, positive reinforcements should be established to provide banks with more incentives to abide by CRA protocols. This could be accomplished in the form of offering subsidies to the highest performing financial institutions. Banks who earn an "Outstanding" rating on their CRA Exam would be eligible for the subsidy. In addition, these financial institutions could use the potential subsidies as a marketing opportunity. Previous alterations to the CRA succeeded in publicizing outcomes as regulators correctly assumed this would further incentivize accordance with the bill. Financial institutions can portray CRA subsidies as evidence of community engagement and ongoing efforts to equalize financial opportunities for all. Thus, these firms can kill two birds with one stone as they can first earn additional income while also touting their social awareness and improving public image. In addition to subsidies, lawmakers could also provide tax deductions for community projects that the aforementioned research project deems to be most associated with economic prosperity. Financial institutions, like all firms, aim to minimize costs and adding an aspect of the CRA that not only accomplishes this but does so in a way to encourage the most prosperous banking activities are sure to yield favorable results for society. The CRA will be more effective with stronger rewards and penalties for those at opposite ends of the compliance spectrum.

The financial world has changed drastically since the inception of the CRA. Levy's own, Hyman Minsky, recognized the dynamic nature of finance. He theorized that there are numerous forms of capitalism that exist. Charles J. Whalen describes how Minsky viewed American capitalism when he says, "Money manager capitalism is the name Hyman P. Minsky (1919-1996) assigned to the current economic era in his historical analysis of U.S. capitalist development. This era emerged in the 1980s as institutional investors—holders of the largest share of corporate stocks and bonds by the end of the decade—began to exert their influence on financial markets and business enterprises" (Whalen 2010). Financial power has been centralized. These institutions have also become major holders of credit market debt. In fact, when compared to depository institutions who are the targets of the CRA, they actually hold a

larger percentage of these assets as can be seen in Figure 3 (Ludwig, Kamihachi, and Toh, 2009). However, these institutions have zero CRA responsibilities but enjoy the benefits of government charters and federal safety nets. Therefore, it is only logical to spread the mission of the CRA onto the whole of the financial players. More specifically, broker-dealers, insurance companies, hedge funds, private equity funds and similar types of firms should be included in the CRA. Conducting CRA exams for non-depository institutions would require a separate exam altogether. But the spirit of the bill should remain. The CRA is predicated on the belief that a more equal financial environment is beneficial to society. Broker-dealers, hedge funds, and private equity funds rarely search for business opportunities in LMI neighborhoods as their business models target more affluent clients by nature. It is to be expected that these types of firms may showcase initial hesitancy when it comes to potential CRA obligations due to their lack of knowledge regarding a new, less-affluent customer base. But, modifications to the CRA Exam for broker-dealers, hedge funds, and private equity funds should follow CRA standards and refrain from setting strict, quantitative goals. Instead, the institutions can work with regulators and the aforementioned CRA committee to tailor their products to the CRA markets while also supporting the work of other financial institutions that are attempting to spread financial products and services to these underserved areas (Ludwig, Kamihachi, and Toh, 2009). Broker-dealers, hedge funds, and private equity funds do not have the same responsibility to the public as compared to the financial institutions already subject to CRA compliance. Therefore, effectively encouraging them to interact with a LMI customer base will require regulators to think outside the box. Like the financial institutions already included in the CRA, the new additions to the legislation will comply with CRA obligations more actively with the introduction of incentives like subsidies. Subsidies may not be enough to convince these firms to broaden their customer base to include the targets of the CRA. Similar penalties aimed at stunting growth opportunities for CRA non-compliance can also be implemented for these new included firms. The addition of other major financial players into the world of the CRA will certainly take time and effort, but doing so would allow the bill to have the greatest impact.

In addition to broker-dealers, hedge funds, and private equity funds, financial technology firms (fintech) should be included in the legislation. Fintech firms did not exist at the time the CRA was passed. However, in today's world these firms play an important role when it comes to extending credit. Banks are no longer the only players in the lending space. Instead, a myriad of fintech firms now occupy this space as well. And their importance is only growing. Between

April 2015 and February 2016, the number of fintech startups exploded from 800 to over 2,000 (Gaughan 2017). These firms have the potential to reach customer bases that traditional community banks may struggle to reach. Therefore, adding CRA obligations for these firms will help generate more equal credit outcomes for LMI communities. The success of fintech-bank partnerships is already well-documented. In 2015, Lending Club and Citibank formed a partnership in which the former originated $150 million worth of loans in hard-to-reach areas while the latter provided access to capital (Gaughan 2017). The author rightfully asks the question "why didn't Citibank directly engage with borrowers?" While there is no single, definitive answer, one possible explanation could be that Lending Club was actually more proficient in serving these communities. Some fintech firms have advantages in regards to the ability to reach certain customer bases. This can be seen in the previously mentioned work done by Ding and Nakamura. Their study found that tracts that lost CRA-eligibility saw an immediate decrease in mortgage ending. However, non-depository institutions worked to fill this gap. The authors found that roughly 52% of the decline in mortgage originations due to lost CRA eligibility in the Philadelphia area was supplemented by the fintech firms. The important role that fintech plays is highlighted in these two examples. Placing these firms under the umbrella of the CRA will only help to continue to the CRA's mission of credit extension and financial equality. Similar strategies implemented for broker-dealers, hedge funds, and private equity funds can also be deployed to encourage the world of fintech to focus on LMI communities. The financial world no longer resembles the one present when the CRA was written. For successful evolution and maximum credit extension, adding fintech firms to the CRA is a vital step.

Like all bills, the Community Reinvestment Act is not perfect. With that being said, evidence shows that it has ultimately been able to accomplish its mission encouraging financial institutions to extend credit to LMI neighborhoods. But just because the legislation can be categorized as generally successful does not mean we should accept the results and its imperfections. The previous chapter compiled a list of grievances that need to be addressed in order to maximize the benefits to society that the CRA can bring. This chapter showed why the CRA has ultimately been successful but also how to improve upon the bill's organization, transparency, data collection, incentives, and sphere of influence. The solutions prescribed are meant to serve as guidelines. The specifics on how exactly to implement the polices needed to affect positive change within the CRA can be debated but their necessity cannot. Much like COVID-19, income inequality has reigned terror on the economy. The CRA has been working

to expand access to credit for over four decades. By working to overcome the deficiencies mentioned, this mission can be better accomplished which will in turn reduce income inequality and foster a more welcoming, equal financial future.

Discussion and Conclusion

As chapter 1 has shown, the CRA has been effective in eliciting higher levels of small business and mortgage loan production as well as nurturing the health of bank branches. These victories, though not alone are enough to combat the raging problem that income inequality is, can certainly help improve financial equity. The following section will provide a closing discussion on the importance of the aforementioned strengths of the CRA.

Small businesses are generally defined as firms with less than 500 employees. They are often called the backbone of the American economy and for good reason. These firms employ over sixty million Americans or slightly less than 47 percent of the total labor force (US SBA Office of Advocacy, 2021). Their roles as job providers for much of the population cannot be overstated. Not only do small businesses serve as employers, but they also serve as staples of community comradery. The pride and local roots of small business owners creates a more genuine and sincere economic experience for consumers. The CRA aims to motivate financial institutions to spur investment in small businesses. In doing so, neighborhoods benefit from employment growth and foundational building blocks of community development. Small businesses accomplish so much for the communities in which they serve and the CRA's ability to support growth in this sector is vital in creating a more equitable financial playing field.

The ability to purchase a mortgage is commonly viewed as a timesaving method to building wealth. According to an article published by Jonathan Eggleston and Donald Hays of the US Census Bureau, "Homeowners' median net worth is 80 times larger than renters' median net worth" (Eggleston and Hays, 2019). As almost all Americans cannot afford to purchase homes in full, a mortgage loan becomes necessary. Expanding access to such an instrumental purchasing tool is importance if financial equity is to be attained. The CRA works incentivize financial institutions to do just that. Redlining has left a scar on the financial system and it is through the CRA that this wound is beginning to heal.

In order for individuals to reap the benefits of expanded credit, they must first be able to actually engage with the institutions providing the financing. This chapter has showcased the positive effects the CRA has had regarding bank branch patterns in LMI neighborhoods. Bank branches in CRA-covered tracts experience less closures and lower probabilities of closures as well. These effects are amplified when there are less bank branches in these locations,

suggesting that the CRA's effect is stronger when it is needed most. The ability to benefit from the presence of financial institutions is increased thanks to the CRA.

In an everchanging economy, access to credit is imperative. The CRA has increased production of small business and mortgage loans in the areas most in need. Bank branches have benefitted from CRA designation and continue to provide a location for customers to obtain financial services. The strengths of the CRA have made strides in creating a more equitable financial landscape.

Chapter 2 has commented on the shortcomings of the bill. The CRA, like all laws, has its flaws. A substandard performance evaluation, suboptimal data, lackluster governance, and weak enforcement all contribute to the muddled efficiency of the bill. All of these shortcomings culminate in a society in which all economic agents are not able to participate to the same degree because of a lack of access to banking services. This uneven dispersion of financial resources hinders economic output as capacity can never be reached. The following grievances contribute to the American economy operating at significantly less than full capacity.

While the CRA was written to provide regulators the flexibility to analyze the complex firms that make up the players of the CRA, the absence of any structure prohibits maximum efficiency. While regulators struggle to accurately determine the degree to which a financial institution is meeting the credit needs of its customer base, banks struggle to implement CRA-friendly strategies into their business plans. If CRA Exams became more uniformly administered, both parties would gain a better understanding of how to optimally serve their communities' credit needs.

In addition to CRA Exams failing to accurately capture the financial institution-community credit need relation, the data used to support the conclusions drawn by regulators is flawed. Inconsistencies and the occasional empty data entries render the CRA Exams misguided from the onset. While changes to the Exam are undoubtably necessary, improved data collection can complement the alterations.

The CRA can only succeed with active participation from the all entities involved. However, a lack of synergy between the Fed, OCC, and FDIC leads to inefficient results. Different data pools and minimal cohesion between the agencies prohibit maximum efficiency of the CRA. In addition to the regulatory authorities, banks also do not share the responsibility of CRA compliance evenly. Financial institutions of all sizes must adhere to CRA standards if income inequality is to become less severe.

Finally, the CRA lacks the enforceable power to make a strong enough impact on financial institution decision making. In addition, this lack of legal vigor sends a message to the financial players that while lawmakers are concerned with lending to LMI neighborhoods, their concern is only up to a degree. What these three ideas tell us is that the CRA is operating well below its maximum efficiency levels. So much more can be done to better alleviate the issues stemming from exclusionary and prejudice banking practices. Credit extension is a necessity if the United States wants to truly improve the financial landscape. And the CRA needs major improvements if this is to ever become a reality.

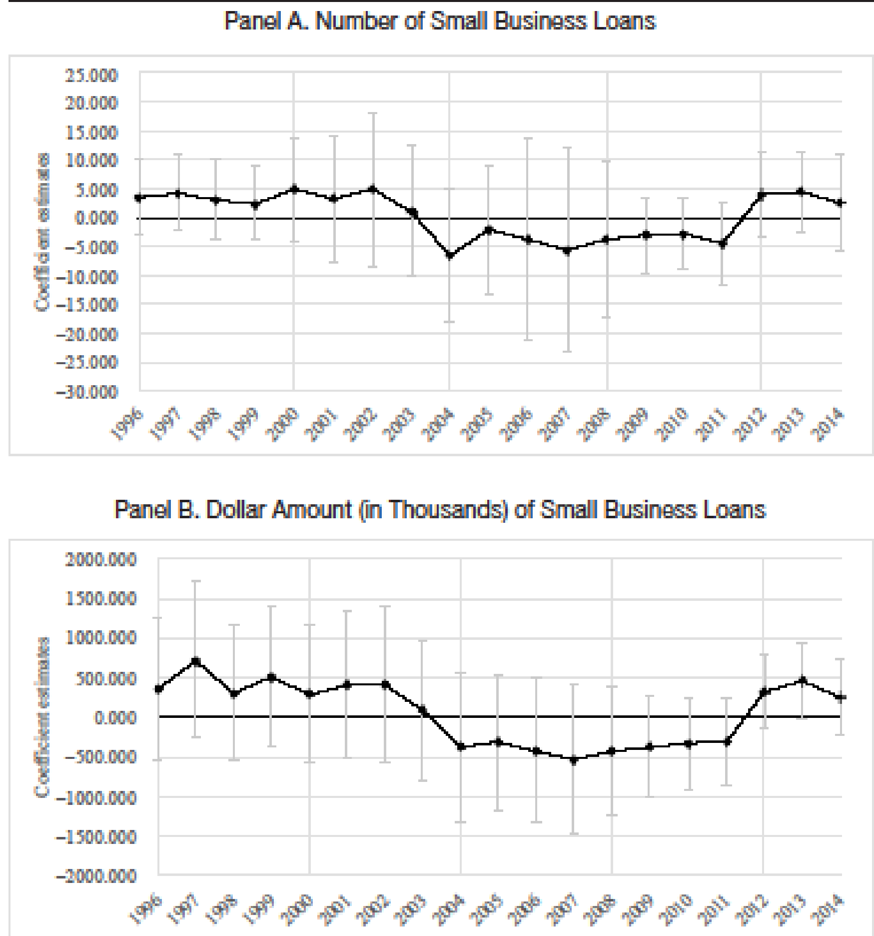
While the CRA is not perfect, it has been successful in extending credit access to those formerly excluded. However, this does not mean that as a society we should be satisfied. Chapter 3 has covered several strategies aimed at alleviating the shortcomings discussed in the previous chapter. The proposed solutions tackle a plethora of issues. Creating a federal CRA committee, refurbishing the CRA Exam, designing a CRA database, and the including other types of financial firms will all work to diminish the hurdles to CRA efficiency. These are just a few suggestions aimed at ultimately creating a more equitable financial playing field.

With that being said, there are additional shortcomings that I would be remiss to avoid mentioning. The CRA came about following the Civil Rights Era in an attempt to reduce the racial inequality in the financial sphere. Yet, there is no way to ensure that CRA lending is helping those it was passed for. LMI neighborhood status only refers to the average income of the census tract. This means that lending within a LMI neighborhood that does not go to a LMI individual will still count for CRA credit. More must be done to ensure that credit access is extended to not only LMI neighborhoods but LMI individuals and more specifically people of color who have been hurt the most by redlining and other predatory banking practices.

The CRA has been attempting to alter the fashion in which financial institutions do business. Though successful to a degree, there is much that can be done to improve upon this result. By implementing the policies found in this thesis, we can continue to work towards a more equitable financial playing field in which inequality is minimized and efficiency, growth, and opportunity are maximized. We cannot accept mediocrity and we must strive to ensure that all Americans have guaranteed access to the financial tools that will help set them up for generations to come.

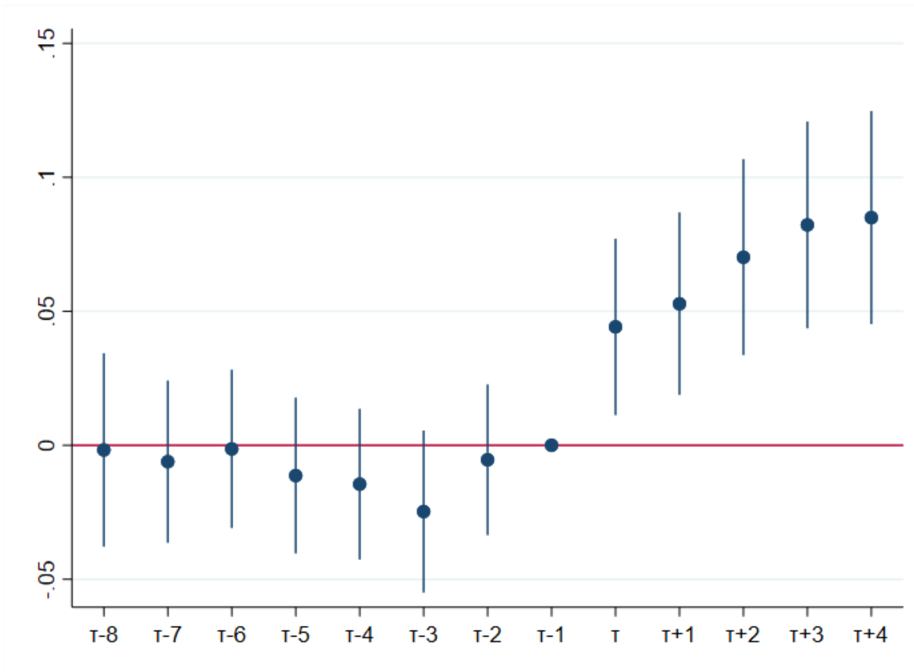
Appendix

Figure 1. Estimated Coefficients on LMI Dummy From Stratified Regressions by Year, 77 to 83 Percent (1 of 2)



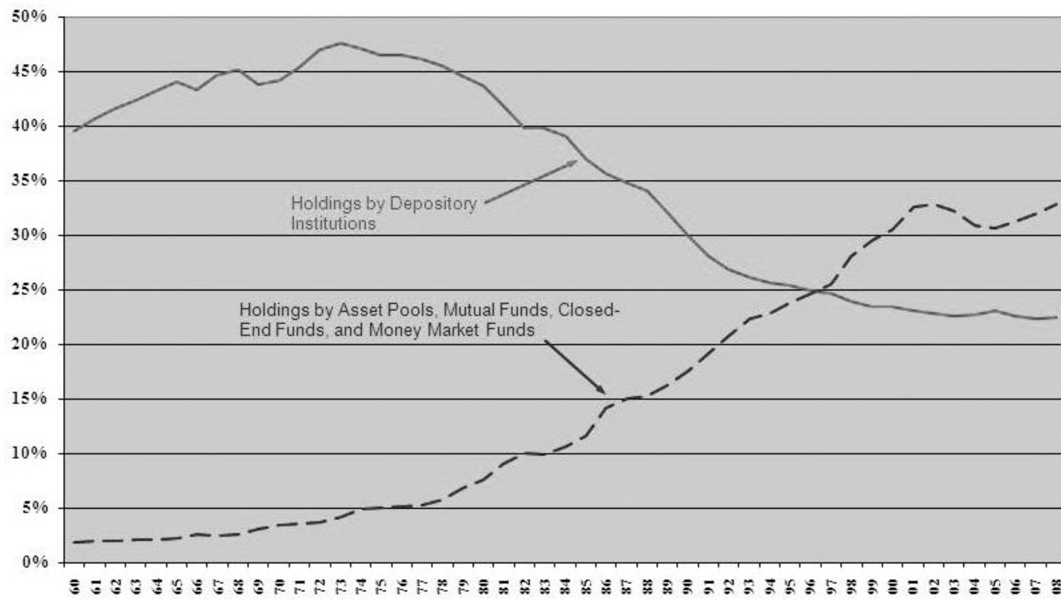
Source: Bostic and Lee (2017)

Figure 2. Lag Effects of Number of Small Business Loans Within 10 Percent Bandwidth



Source: Kim, Lee, and Earle (2021)

Figure 3. Market Based Lenders Have Surpassed Depository Institutions as Holders of Credit Market Debt



Source: Ludwig, Kamihachi, and Toh, (2009)

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