

**Statement of Janneke Ratcliffe  
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**Before the  
Board of Governors of the Federal Reserve System  
Federal Deposit Insurance Corporation  
Comptroller of the Currency  
Office of Thrift Supervision**

**Hearing on  
Community Reinvestment Act Regulations  
August 6, 2010**

I am honored to be asked to share thoughts on the Community Reinvestment Act, particularly the service test. Your review comes at a critical time, as our financial system is being rethought, and communities and families are trying to rebuild. Today, as in 1977, the hope is that CRA can foster a more inclusive path to financial opportunity that strengthens all of our communities.

The role of the Act in mortgage lending has received much attention. Ample evidence shows that, while the broader market pursued reckless practices, CRA loans remained a constructive source of credit for low income and minority families.<sup>i</sup> Mortgage lending is not the only test. But it and small business lending are dominant evaluation factors, because access to such productive capital is critically important for a community to flourish.

But building financial opportunity from the ground up doesn't begin with homeownership. CRA encourages banks to meet the "need for credit services as well as deposit services,"<sup>ii</sup> thereby recognizing that basic financial services are the gateway to other opportunities such as homeownership and entrepreneurship.

If that is true, then we have a problem. A recent FDIC survey finds a quarter of U.S. households are un- or underbanked, including 54% of black and 43% of Hispanic households. Nearly one in five lower-income households does not have a bank account at all.<sup>iii</sup> Further, between 35 and 70 million Americans lack sufficient credit history to determine a credit score.<sup>iv</sup> For such individuals, reliance on alternative financial services adds costs and handicaps one's chance of achieving greater financial security.

Yet, from the ratings on CRA tests, it appears that our banks are meeting the credit needs of their communities well. In the prior two years, 98% of large banks rated satisfactory or better (25.3% Outstanding and 71.5% satisfactory),<sup>v</sup> and rejections of bank applications for merger or acquisition on CRA grounds are extremely rare.<sup>vi</sup>

Consider Charlotte, where Wachovia and Bank of America hold 92% of deposits and both received “Outstanding” ratings on their 2006 service test. Yet, in this banking city, 37% of households (286,000 total households), are un- or underbanked (10.9% unbanked; another 26.5% underbanked), above the national average.

We can only conclude that the service test must be measuring the wrong thing. It is time to find a new approach. We offer two recommendations.

First, better assessment tools. In 1989, the passage of FIRREA (Financial Institutions Reform, Recovery and Enforcement Act) advanced the public availability of both CRA ratings and HMDA data. Today, HMDA provides information on access to and quality of mortgage credit that is widely used by community advocates, researchers, policymakers, and the industry itself. And it allows for a data-driven mortgage lending test.

In contrast, the CRA service test is very subjective.<sup>vii</sup> This subjectivity creates an opportunity for grade inflation, as described in the research by Michael Stegman.<sup>viii</sup> The most tangible element is a review of the distribution of branches and ATMs across socioeconomic neighborhood status, for randomly selected markets.<sup>ix</sup>

Branch presence is important for serving communities, but in and of itself does not mean the needs are being met. Imagine on the mortgage side if all we knew was whether a lender had offices located in LMI census tracts, for only some markets for that lender, for only some years. And imagine that we had to get that information in narrative form by going through each lender’s examination. What could we possibly discern about the provision of mortgage loans to lower income and minority households?

A more quantitative service test could “determine whether depository institutions are filling their obligations to serve the *financial services* needs of the communities and neighborhoods in which they are located.”<sup>x</sup>

Our second recommendation is to better address the needs of the community using a consumer-centered view. Underserved consumers needed low-cost bank accounts; they did not need checking accounts that are advertised as free, but with built-in snares that had those with the least disposable income cross-subsidizing checking accounts for the rest of us. They need low cost savings accounts, not accounts where the monthly fees far outweigh interest earned.

In an FDIC survey of banks, less than 18% identify expanding services to the un- and underbanked as a priority, and most have undertaken no research on this potential opportunity.<sup>xi</sup> But there is extensive research available into what underbanked and low income people want in transaction accounts. We can also look to the non profit, community-based financial institutions as a source of insights.

Research also tells us that the needs go beyond accounts, mortgages and business loans. One of the clearest needs is for small consumer loans, provided they are responsible, transparently priced and repayable. Today, consumer lending is a minor element in the evaluation, and should be examined given more weight.

In closing I encourage you to broaden the service test through incorporating the community perspective in defining credit needs and to collect more quantitative data to determine how well those needs are being met.

Thank you for your attention. I will be pleased to answer any questions.

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<sup>i</sup> Kevin Park (2010). "CRA Did Not Cause the Foreclosure Crisis." Center for Community Capital. [http://www.ccc.unc.edu/documents/CRA\\_Did\\_Not\\_Cause\\_Foreclosure\\_Crisis.pdf](http://www.ccc.unc.edu/documents/CRA_Did_Not_Cause_Foreclosure_Crisis.pdf)

<sup>ii</sup> "Community Reinvestment" Title 12 U.S. Code Sec. 2901. 1977

<sup>iii</sup> Federal Deposit Insurance Corporation (2009). "National Survey of Unbanked and Underbanked Households." <http://www.fdic.gov/householdsurvey/>

<sup>iv</sup> Erica Maas (2008). "Credit scoring and the credit-underserved population." Federal Reserve Bank of Minneapolis. [http://www.minneapolisfed.org/publications\\_papers/pub\\_display.cfm?id=2452](http://www.minneapolisfed.org/publications_papers/pub_display.cfm?id=2452)

<sup>v</sup> <http://www.ffiec.gov/craratings/default.aspx>

<sup>vi</sup> Between 1988 and 2007 of over 13,500 application for the formation, acquisition, or merger of banks reviewed by the Federal Reserve Board, only eight were denied based on unsatisfactory consumer protection and community needs issues. Sandra Braunstein (2007). "Bank mergers, Community Reinvestment Act enforcement, subprime mortgage lending, and foreclosures ." Testimony before the Subcommittee on Domestic Policy, Committee on Oversight and Government Reform, U.S. House of Representatives, at the Carl B. Stokes U.S. Court House, Cleveland, Ohio. May 21, 2007. <http://www.federalreserve.gov/newsevents/testimony/braunstein20070521a.htm>

<sup>vii</sup> Geoffrey Smith, Malcolm Bush and Nathan Paufve (2007). "Measuring the Provision of Banking Services for the Underbanked: Recommendations for a More Effective Community Reinvestment Act Service Test." Woodstock Institute, Reinvestment Alert Number 37.

<sup>viii</sup> Michael Stegman, Kelly Cochran and Robert Faris (2002). "Creating a Scorecard for the CRA Service Test." Brookings Institution, Policy Brief No. 96.

<sup>ix</sup> For example, according to its 2006 CRA evaluation, Bank of America, N.A., a bank with \$1.2 trillion in assets, over 5,700 branches, and 17,000 ATMs across 29 states and the District of Columbia, was evaluated on just 42 of its 277 assessment areas.

<sup>x</sup> 12 U.S.C. § 2801 : US Code - Section 2801

<sup>xi</sup> Federal Deposit Insurance Corporation (2008). "National Survey of Banks' Efforts to Serve the Unbanked and Underbanked." <http://www.fdic.gov/unbankedsurveys/>