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By: Angela Duran
Director of Policy Development

The Financial Services Modernization Act's Effects on the Community Reinvestment Act

HIGHLIGHTS

- New banking bill affects CRA
- Banks must have satisfactory CRA rating to merge with insurance or securities firms
- CRA agreements must be disclosed
- CRA review schedule for small banks changes

On November 12, President Clinton signed S. 900, the Financial Services Modernization Act. This new act is the result of many years of effort by the financial services industry to eliminate the barriers that have prevented banks, securities firms and insurance companies from owning one another. The act sets the stage for a new wave of consolidation among financial services companies. This new Financial Services Act also has some implications for the Community Reinvestment Act, which originally passed in 1977 and was substantially amended in 1989. Below is a summary of the provisions of the Community Reinvestment Act prior to the enactment of this new law and a summary of how the new law affects the existing Community Reinvestment provisions.

COMMUNITY REINVESTMENT ACT PROVISIONS

The Federal Community Reinvestment Act (CRA) was passed to address the issues of redlining (defining particular geographic areas where loans will not be made). Under the law, banks and savings institutions must take steps to meet the credit needs of the entire community they are chartered to serve, including low- and moderate-income areas. If they do not, they can be denied a request to open a new branch or merge with or acquire another bank.

GOOD FAITH FUND
Planting the seeds for success
2304 W. 29th Avenue
Pine Bluff, AR 71603
Phone: 870-535-6233
FAX: 870-535-0741
E-mail: aduran@ehbt.com

Assessment Factors. Regulatory agencies evaluate banks and savings institutions on twelve CRA assessment factors, which are grouped into five performance categories. The categories are 1) ascertainment of community credit needs; 2) marketing and types of credit offered and extended; 3) geographic distribution and record of opening and closing offices; 4) discrimination and other illegal credit practices; and, 5) community development. In the review, the regulatory agency will

Ratings. Institutions are assigned one of the following four ratings: "outstanding," "satisfactory," "needs improvement," and "substantial non-compliance." These ratings are made public and can be viewed on the web site of the Federal Financial Institutions Examination Council at http://www.ffiec.gov/cracf/crarating/main.cfm.

Examination Process. The frequency of bank examinations for CRA compliance depends on the size of the bank, its supervisory agency, and its most recent CRA rating. The exam cycle can range from six months for an institution with an unsatisfactory rating on its last exam, to twelve months for a national bank with assets of a billion dollars or more, to several years for smaller banks.

New regulations, published in 1995, address concerns regarding paperwork burdens on banks and the process rather than performance nature of the evaluations. Small banks (under $250 million in assets) now have a more streamlined process that focuses on their loan-to-deposit ratios, the geographic distribution of loans made, their record of lending and lending-related activities for borrowers of different income levels and businesses of different sizes, and their actions in response to any written complaints received about their CRA performance. Larger banks are being evaluated based on their lending, service and investment activities. These larger institutions, for the first time, are being required to disclose information about their small business lending activity, as well as their mortgage lending activity outside of metropolitan areas.

Any bank can choose to be evaluated under the "strategic plan" option, which permits the institution, in consultation with local community representatives, to develop its own plan for addressing local credit, investment and service needs. Strategic plans can be up to five years in length, and must include annual interim measurable goals. The plans allow the institution to get prior approval for activities, which if carried out effectively, will earn it a satisfactory or outstanding CRA rating.

Improving and Maintaining CRA Ratings. If a bank has a weak CRA rating, they can develop programs that spell out the specific affirmative steps they will take to improve their lending record in low- and moderate-income neighborhoods. As a result of CRA, lenders have made what some estimate to be more than a trillion dollars in commitments for loans targeted to residents and businesses located in underserved urban and rural America. Modest-income families, small businesses, and small family farmers have benefited from CRA through increased opportunities to purchase a home as well as start-up and business expansion loans. The law has served to "jump start" the market in these communities. All of this has happened at no cost to the taxpayers, and research shows that lenders that have taken CRA seriously have found that it is good, profitable business.

EFFECTS OF THE FINANCIAL SERVICES MODERNIZATION ACT ON THE COMMUNITY REINVESTMENT ACT

CRA Statute Maintained. The existing Community Reinvestment Act was, for the most part, untouched. However, there were a few important changes. The application of CRA to the newly allowed mergers and expansions and a few other changes to the existing CRA are outlined below.

Banks are required to have a "satisfactory" CRA rating to expand. If banks want to expand their services or merge with other financial institutions, securities firms, or insurance companies, they must have a satisfactory CRA rating. Banks or bank holding companies must meet this requirement each time they want to expand. In earlier versions of the bill, they would have been required to maintain a satisfactory rating; however, that requirement was dropped in negotiations over the final bill.

Disclosure of CRA Agreements. The new act includes a "sunshine" provision that requires the disclosure of CRA agreements between banks and non-governmental entities. Such agreements must be made public and filed with bank regulators. A CRA agreement is any written contract involving cash payments, grants, or other considerations with an aggregated value in excess of $10,000 or loans of more than $50,000. This provision applies only to agreements made in connection with the fulfillment of an institution's CRA obligation. The provision will only be applied if the non-government entity has filed comments on the bank's CRA performance. Only groups that exercise their rights under CRA to comment on a bank's application to expand will be subject to the sunshine provision.

Adjustment to CRA Schedules for Small Banks. Small banks (with less than $250 million in assets) will not be exempted from CRA as had been proposed in one earlier version of the bill. Banks with less than $250 million in assets and an "outstanding" CRA rating will be subject to CRA exams every 5 years. Those with a "satisfactory" rating will be examined every 4 years, and those with less than "satisfactory" ratings will be subject to the current cycle as determined by regulators. Regulators still have the discretion to examine any small bank more frequently if they deem it necessary. And this new schedule does not affect examinations in connection with a bank's application to expand its services.

Commissioning of Two Studies. The new act authorizes two studies. The first is a study of default rates, delinquency rates, and profitability of loans made under CRA. This study is to be completed by March 15, 2000. The second study will look at the extent to which services are being provided to low-income individuals after the enactment of the new act. The Treasury Department will conduct this study, which must be completed within two years of enactment of the act.

[1] Sources for this issue of *Policy Points* include summaries of the new legislation from the Center for Community Change and Rapoza Associates. For more details on the new law see the Center for Community Change's home page at www.commchange.org.