The Daily Dish

The Exception That Makes the Rule (About Rules)

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The history of Eakinomics is replete with regulatory missteps, rulemaking foolishness, and an economy festooned with red tape. Every now and then, however, a surprise emerges. The Community Reinvestment Act (CRA) of 1977 was intended to prevent banks from discriminating against individuals from low-income areas. As discussed by Thomas Wade, this past week, the three regulators who oversee the CRA – the Federal Reserve (Fed), Federal Deposit Insurance Corporation (FDIC), and Office of the Comptroller of the Currency (OCC) – released a proposed rulemaking that modernizes the CRA.

It's about time. As Thomas Wade puts it: "the CRA has not been meaningfully updated since implementation and does not reflect the development of online banking at all (as originally drafted, the CRA did not even account for *interstate* banking). As banks increase their range of internet banking services, the CRA is increasingly redundant – and that redundancy actually harms some banks, such as Ally, that operate only online. Even today banks are judged on the services they provide to vulnerable populations within a given 'assessment area,' the geographic region around a physical branch."

There are three main reasons for reform. First, currently the CRA relies on servicers having brick-and-mortar locations, like branches and ATMs. Accordingly, CRA evaluation excludes online lending. Ally – the only fully online bank in the United States – receives no credit for fair lending in Detroit, where it is headquartered.

Second, the CRA does not adjust for the size of a bank. It just looks at the raw number and value of loans to low- and middle-income customers, producing a completely unfair comparison between global giants and community banks.

Finally, the assessment itself is poorly defined. It is based on interviews, uses no metrics, and banks have no real reason to understand the vague and undefined assessments ("excellent," "substantial").

Two of the key goals of the proposed rule are to update the approach to assessment areas and revise the bank evaluation framework. There would also be new record-keeping, data collection, and disclosure requirements. The proposal would augment the brick-and-mortar approach by allowing large banks to identify areas where they had "an annual lending volume of at least 100 home mortgage loan originations or at least 250 small business loan originations in a geographical area for two consecutive years. The proposal also includes a nationwide assessment that would allow banks to receive CRA credit for any qualified community development activity regardless of location."

There is also a new categorization of banks: “Existing and new tests will be categorized under four new groupings – a Retail Lending Test, Retail Services and Products Test, Community Development Financing Test, and Community Development Services Test. Large banks will be assessed on all four tests. Intermediate banks would be evaluated under only the Retail Lending Test and the pre-existing community development test. Small banks would be assessed solely on the pre-existing community development test.”

The new CRA rule is a long-overdue step in a modern direction and will be subject to public comment. One can be sure that those comments will prove that it isn’t perfect. The most obvious criticism is that the proposal will center on intensive and costly new data collection, recording, and disclosure requirements. Even this positive development for the CRA can’t seem to do away with that red tape.