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Blaming Minorities for the Meltdown

As the financial markets sink rapidly into the stormy sea of deregulation, ultra free market advocates looking for a scapegoat have resurrected their claim that a relatively unknown law, the Community Reinvestment Act of 1997 (CRA) is to blame. In particular, they claim that a revision of the CRA regulations in 1995 forced lenders to make risky loans to unworthy borrowers in order to serve an essentially minority market. They claim the regulators threatened banks with huge penalties and forced them to invest in subprime loans. From my own experience helping to draft the CRA, making formal evaluations of CRA programs, and in preparing testimony before Congress several times on the CRA on lending issues, I offer these challenges to the claims.

First, the CRA applies only to depository institutions and simply requires that banks fairly serve the “convenience and needs” of their entire community as a *quid pro quo* for the Federal guarantee of consumer deposits. The law was created by community groups responding to the racial discrimination (redlining) by banks that abandoned minority markets in the late 1960s to high risk government loan programs that had eliminated sound underwriting practices. Massive fraud and exploitation on the part of lenders and real estate agents destroyed whole sections of American cities.

After the passage of the CRA in 1997, community-based organizations in partnership with banks and savings institutions created programs that invested billions of dollars into rebuilding inner-city, small town, and rural communities across the country and across the racial spectrum. A review by the Federal Reserve found that such special CRA programs had a median loss ratio of zero.

The Blame CRA Campaign claims that the revision of the CRA regulations in 1995 forced lenders to invest in subprime loans and imposed harsh penalties on lenders who did not. On the contrary, the regulators made a point of emphasizing that nothing in the regulations sanctioned risky loans and that no specific loan standards, ratios or measures would apply to any lender. The regulations actually deleted prior provisions that allowed the regulators to enforce the CRA with the full range of penalties and restricted future enforcement to taking account of the CRA record in reviewing applications for new branches, acquisitions, and mergers. Under the CRA, regulators evaluate bank performance and provide ratings. From the ensuing CRA exams, more than 95% of lenders were given satisfactory ratings, essentially ensuring that all their applications would be approved.

Far from forcing lenders to make loans in minority markets, the regulators gave high ratings to some lenders that explicitly excluded minority areas from their service areas. In one case, a major national lender, Flagstar, had its CRA rating increased from satisfactory to outstanding after a Federal court found it liable for blatant discrimination

by implementing a written policy specifically basing loan fees on the race of the applicant. Ironically, even though these lenders received high CRA ranks and all their applications for expansions were approved, some were sued by the Department of Justice for violating Federal fair lending laws.

While it is true that the regulators did begin to give high marks to lenders who concentrated subprime loans in minority markets, it was the organizations from these inner-city and low- and moderate-income communities, and not the banking industry, that challenged this perverse application of the law. The 1995 regulations should have prevented giving CRA credit for any risky loans while investments in subprime securities should not be counted under the CRA as their main purpose is not “community development” as the regulations require.

For over a decade, community organizations have been providing reports detailing the harm of subprime lending and warning the government of the coming market disaster. These warnings went unheeded and many of these communities now look like Katrina without the water, decimated by foreclosed and abandoned homes. In the process billions of dollars in reinvestment have been wasted.

The Blame CRA Campaign wants to blame the victims and to ignore the high levels of fraud and exploitation in the subprime markets. Data from Treasury indicate that reports of lending fraud have increased thirty-fold since 1997. Collectively, the Federal Trade Commission and the attorneys general in every state have sued some of the largest lenders in the subprime markets (The Associates, Household Finance, or Ameriquest) for deceptive and abusive practices, resulting in over a billion dollars in settlements. None of these lenders were covered by the CRA. Covered lenders make only a small share of all subprime loans. The Comptroller of the Currency, for example, has continually pointed out that only 10% of the subprime loans have been made directly by national banks.

Blaming Fannie Mae and Freddie Mac (called the GSEs) that are not covered by the CRA plays on half truths. While they did contribute mightily to the present crisis, it was not in their own community lending programs. Rather, the loans now entering the foreclosure pipeline, for the GSEs and the overall subprime market, are increasingly what are termed Alt-A loans. These are loans to people with good credit who provide only limited documentation of their income and/or have high debt ratios or other high risk factors. These loans disproportionately have gone to higher-income white borrowers. Also, while the GSEs proclaimed they would not buy individual risky subprime loans through the front door, in a monumental expression of corporate hypocrisy, they became some of the largest purchasers of subprime securities on Wall Street through their back door.

Underpinning the Blame the CRA Campaign is the assumption that minorities – especially blacks - are so financially untrustworthy and such a high lending risk that making loans to blacks has pushed the entire American economy to the brink of collapse. This is an exceptionally scantily veiled form of racism. To lay blame on the minority

markets whose representatives have been sending out warnings for over a decade is to blame the canaries in the mine for the explosion.