Is CRA Working?

By Jeffrey Marsico

In Richard J. Parson's book, "Broke: America's Banking System," he suggested that bankers and examiners major in the majors. By that, he meant sweat the big stuff, and by big stuff, he meant risks that tend to lead to bank failures.

Lead among them, and without a near rival, is credit risk. Bankers and examiners do spend a fair amount of time mitigating a bank's credit risk and systemic credit risk. But a close second in time and resources is the focus on complying with the myriad of laws and regulations on the books that have little to nothing to do with what causes banks to fail.

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Many relate to social engineering, ensuring bankers are "fair," as defined by politicians and bureaucrats. This includes transparency in the form of disclosures, which few read, and add to the complexity of doing something simple like getting a long-term loan collateralized by your house. All of the paperwork customers must produce and sign is the result of, you guessed it, bureaucrats.

So we move on, and start dedicating resources, financial and human, to comply, like bankers do with so many other rules, regulations, standards, exam practices and laws that have infiltrated the banking system. Some laws were designed so bankers can be clandestine FBI agents, trolling their customers' transactions for nefarious activity. Think BSA.

On the topic of social engineering, let me paint the bullseye on one that I think, by objective standards, did not work, yet continues to cause much angst amongst bankers and regulators alike: the Community Reinvestment Act (CRA).

THE COMMUNITY REINVESTMENT ACT

The Community Reinvestment Act was enacted by Congress in 1977 and was intended to encourage depository institutions to help meet the credit needs of the communities in which they operate, including low and moderate income neighborhoods, consistent with safe and sound banking operations.

In other words, it encouraged, even compelled, banks to lend to low income individuals under the presumed assumption that if only a low income person could borrow money they would elevate their economic status.

CRA requires that each insured depository institution's record in helping meet the credit needs of its entire community be evaluated periodically in the form of a CRA exam. That record is taken into account in considering an institution's application for deposit facilities, including mergers and acquisitions.

The literature I read about CRA states the end goal as lending into low-to-moderate communities. But that is not the goal. It is a means to an end. What end? I recently attended a United Way presentation where the local chapter's CEO said that one goal of the organization was to "cut our poverty rate in half." That's a goal! I'm surmising CRA, similar to United Way, hoped to be an ingredient in reducing the poverty rate.

Do you know how difficult it is to find data when conducting a search on "has the Community Reinvestment Act worked"?

I decided to see what has happened to the poverty rate in New Jersey. The accompanying chart shows poverty rates in the state since 1980, the earliest the Census had the data, and not too distant from when the CRA was passed. You may note that poverty has actually increased. By this standard, CRA hasn't worked.

Isn't it time we pulled the plug on CRA? Give it a "Needs to Die" rating, so to speak. In fact, I would propose that any law designed to improve the plight of our citizenry should have a litmus test. If the results don't pass the litmus test within a given time frame, the law dies. But that's a larger argument for another day.

Think about how much time and resources are spent on CRA. Wouldn't our examiners time be better spent on things that are most likely to cause banks to fail, such as credit risk, or interest rate risk? Our system would be safer and more sound, in my opinion.

Banks in general, and community banks in particular, should have their own social improvement programs. Why? Banks are intricately tied to the plight of the communities in which they operate. If the local military base or large manufacturer pick up stakes and leave, the local community bank better be part of the action plan to replace that economic activity.

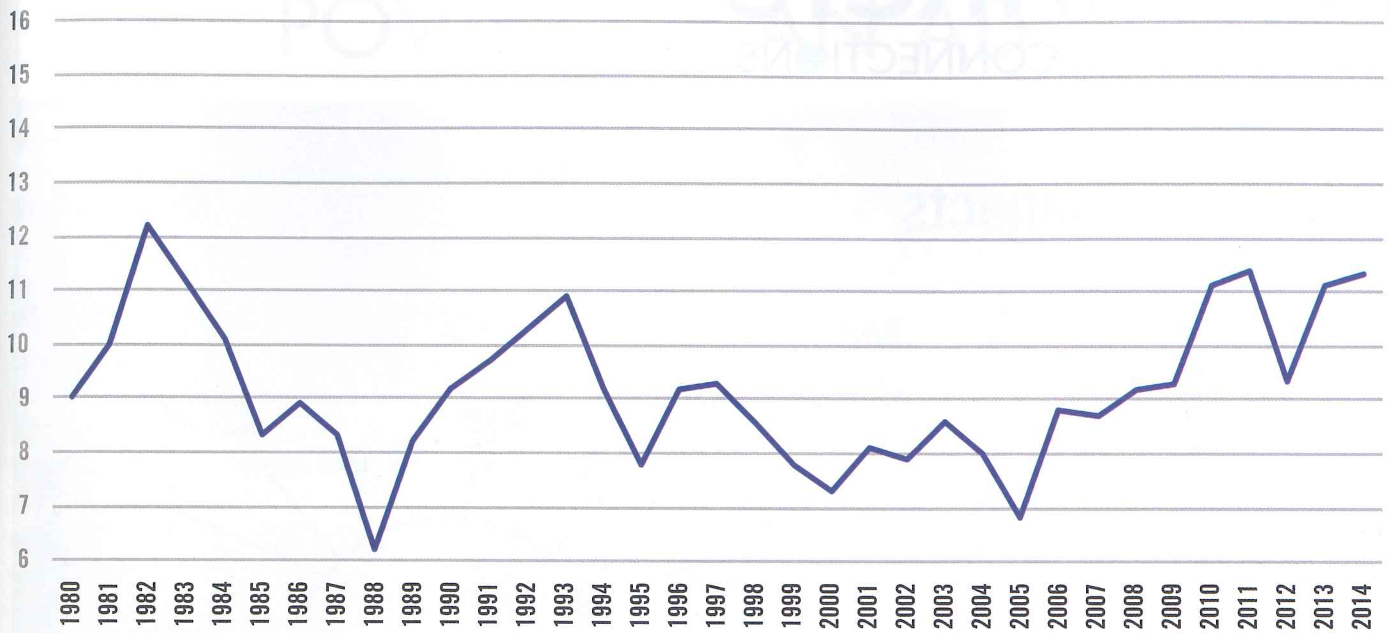
THREE IDEAS TO REPLACE CRA

If CRA were to be pulled, here are more productive things I think community financial institutions could do with their newfound available resources.

1) **Build a scholarship fund for skills transition.** Technology has accelerated economic change and the skills needed to succeed in our new world. We don't need a riveter that affixes car doors, and the union prevents them from moving to help out the dashboard installer. Instead, we need workers that can operate and repair robotic arms. This is only one example of the skills transition needed in today's rapidly changing economy. Banks can be a part of helping residents make those transitions.

2) **Train employees to be concierges** to help local residents access private and public assistance to improve their lives. There are myriads of programs, scholarships, and resources available to help low and moderate income people elevate their economic status. But it's complicated and it requires mentorship, guidance, and experience. Instead of the haphazard way that community financial institution employees volunteer, and receive paid time off to volunteer, channel their efforts for a finite set of objectives to help people and their communities rise up.

NJ Poverty Rate



Source: Census.gov

3) **Sponsor a local "Shark Tank."** "Shark Tank" is one of my TV indulgences. It puts entrepreneurs in front of a panel of private investors to pitch their business and get funding. Genius! Why don't we do this? Lack of capital is a primary reason for business failure, or its inability to achieve scale. Why can't a bank, through its holding company, have an equity fund that they contribute to, along with local private investors? A panel of investors could evaluate local businesses and award capital to the most promising ones. As CRA stands now, lawmakers and examiners would have us lend to these businesses. But a loan to an early stage business is like an equity investment with no upside, and servicing debt puts pressure on the business's cash flow. It doesn't make sense.

These are just a few ideas that community financial institutions could employ to improve the economic status of their communities, and in so doing improve the prospects for the bank to thrive.

Or, we could continue to log our community hours on a spreadsheet as part of the documentation needed for a good CRA rating. ■

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