Viewpoint

CRA Didn't Lower the Bar on Standards

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Recently a small but vocal group of critics have sought to portray the Community Reinvestment Act as a principal cause of the financial crisis.

These individuals allege that because of regulatory pressure, banks downgraded their standards for originating mortgages to comply with their CRA obligations to lend to low- and moderate-income individuals.

According to the skeptics, this "lowering of the bar" has facilitated or precipitated the current wave of delinquencies, defaults, and foreclosures.

Because this argument is incongruous with our prior statistical research and our experience counseling banks on CRA compliance since 1990, we posited the following hypothesis:

If critics were correct about banks having lowered underwriting standards for low- and moderate-income borrowers, lending data from 2007 should show greatly diminished service to these borrowers.

Unlike 2006, when banks largely reported unchanged credit standards on residential mortgages, the Fed's quarterly surveys of bank lending practices for 2007 found that most banks tightened their standards, particularly for nontraditional and subprime loans. As noted by the Fed's Division of Research and Statistics, there was "a sharp contraction in 2007 in the willingness of lenders and investors to offer loans to higher-risk borrowers or, in some cases, to offer certain loan products that entailed features associated with elevated credit risk."

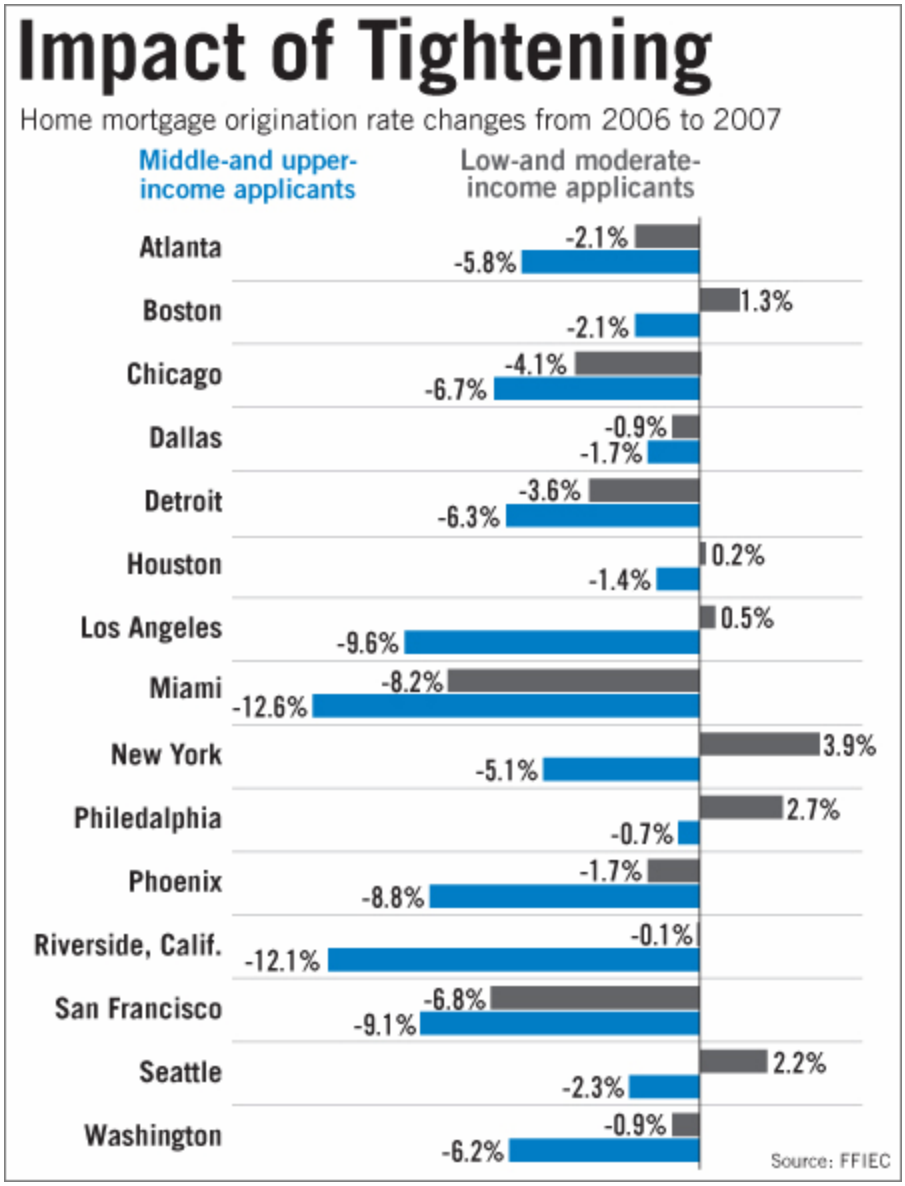
Moreover, far from demanding that banks adopt "flexible" lending practices to serve low- and moderate-income borrowers, federal regulators emphasized safe, sound, and transparent mortgage lending in 2007, focusing on limiting exotic products and strengthening consumer protections.

Given the change in regulatory focus, CRA-subject banks were, in our opinion, far less likely to fear that regulators would have objected to a cessation of any alleged preferential treatment for low- and moderate-income borrowers and the lending decline that would inevitably follow. Thus, if critics were right about banks having lowered the

bar, tougher credit standards should have resulted in a substantial decrease in such lending by CRA-subject banks in 2007.

To test our hypothesis, we looked at 2007 and 2006 Home Mortgage Disclosure Act data from the 15 most populous U.S. metropolitan statistical areas. If, as critics allege, low- and moderate-income mortgage applicants in prior years were judged by lax or negligent standards, the rate at which such applications were originated in 2007 should have significantly decreased.

However, even with widespread tightening of credit standards in 2007, there was essentially no change in the origination rate by CRA-subject banks for these applications.



In the metropolitan statistical areas reviewed, the rate at which these banks originated mortgage applications from low- and moderate-income individuals was nearly the same in 2007 as in 2006. In the Boston, Houston, Los Angeles, New York, Philadelphia, and Seattle MSAs, the 2007 rate was somewhat higher than the 2006 one.

Significantly, while the origination rate for low- and moderate-income mortgage applicants remained stable in 2007, the rate for middle- and upper-income applicants fell 6.6%. In each of the MSAs, the origination rate for middle- and upper-income applicants decreased by more than the rate for low- and moderate-income ones.

This suggests that it was the underwriting standards for upper-income applicants that required tightening, not the standards for low- and moderate-income applicants.

In terms of applications received and loans originated, the contrast between what happened to these two groups from 2006 to 2007 further undercuts the argument that lower underwriting standards for low- and moderate-income borrowers caused the home mortgage crisis.

Though the actual number of originations for these applicants by CRA-subject banks fell 8.2% in 2007, this was only half a percentage point more than the 7.7% decrease in applications received. For middle- and upper-income applicants, the difference between applications received and loans originated was nearly 7 percentage points.

Our finding that the origination rate for low- and moderate-income applicants by CRA-subject banks remained stable even in a climate of heightened scrutiny contradicts the notion that compliance is dependent on imprudent lending.

Thus, we conclude that the CRA cannot be rationally blamed for current problems in the mortgage market, much less for the U.S. financial crisis.

That CRA-subject banks continue to make mortgages to these borrowers while strengthening their underwriting standards not only undermines the claims of critics, but it also suggests that without the 32-year-old law, the mortgage market might be in even worse condition.

This suggestion is reinforced by our analysis of mortgage data published in 2008, which showed CRA-subject banks were substantially less likely than other lenders to engage in the risky lending practices that helped fuel the crisis.

This finding was recently confirmed by a Federal Reserve Bank of San Francisco review of low- and moderate-income lending. "The CRA, and particularly its emphasis on loans made within a lender's assessment area, helped to ensure responsible lending, even during a period of overall declines in underwriting standards."

Finally, critics have chosen a particularly inauspicious time to attack the CRA. We are in the midst of a crisis that has Congress and the executive branch, including the Treasury Department and banking regulators, seeking the best way to free up credit. Right now the CRA, a law that has spurred responsible lending to underserved borrowers, looks like a particularly wise and inspired piece of legislation.

Policymakers should consider looking to the CRA for guidance on how the government can spur responsible lending to other qualified borrowers.

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