on their loans. This could help lessen the foreclosure crisis and contribute to stabilizing home prices. The challenge of creating jobs, stabilizing communities, and getting banks back into the business of lending will be further undermined if the foreclosure filings continue to escalate.

So let's tell Congress: You've taken care of the banks. It's time to assure that those who elected you at least have the chance to start or expand businesses or to become homeowners the old-fashioned way, borrowing money from a lender that is not predatory, usurious, or disengaged. TAP

John Taylor is the president and CEO of the National Community Reinvestment Coalition and has worked to increase economic opportunity for working-poor Americans for over 25 years.

Community Reinvestment: The Broader Agenda

CRA has created a cadre of community-friendly bankers. It's time to bring reinvestment policy into the 21st century.

BY MARK A. WILLIS

The world of banking and of community development is very different than it was in 1977 when Congress enacted the Community Reinvestment Act (CRA). Thirty-two years ago—with cities still in an urban crisis of broad economic decline and with civil-rights legislation only a dozen years old—CRA laid out an affirmative obligation for banks to expand access to credit in local service areas for "underserved" communities. Under pressure from both activists and regulators, banks significantly increased their investments in neighborhoods formerly written off, and bankers commenced constructive dialogues with community groups. In these terms, CRA has been a success.

Today, however, the regulatory tools of CRA are a poor fit with the machinery of the new world of mega-banks and mortgage finance that evolved since the 1990s, let alone the wreckage of the industry after the crash. The core CRA concept of a bank's local service area hardly fits a Bank of America or a Wells Fargo. The three largest banks in the country now hold almost 30 percent of the nation's total deposit base. In recent years, loosely regulated non-bank competitors such as the mortgage companies that helped fuel the explosion of sub-prime home mortgages were able to capture significant chunks of the marketplace. CRA–regulated depository institutions' share of household assets and consumer loans both have fallen roughly 40 percent over the last three decades.

Not only does CRA now miss a lot of the action, it has also lost some of its bite. Banks see less value in striving for an "outstanding" CRA regulatory rating. Moreover, the CRA pressure points for advocates, such as applications for bank mergers that regulators must approve, are less potent, given the number of recent shotgun mergers sponsored by regulators to shore up weak banks in the current emergency. At the same time, the largest banks have increasingly addressed CRA goals through their mainstream business units, to the detriment of specialized units that historically have been a major source of innovations and partnerships with community-based organizations and with government. Worse perhaps, CRA also doesn't focus enough on areas where banks could have the most impact in revitalizing and strengthening low- and moderate-income communities.

So, in this era of intended financial-sector reform, what can we learn from the past 32 years? What does an "affirmative obligation" mean in the new context? How can CRA itself best be overhauled? Should CRA be stretched even more by taking on additional roles such as examining discrimination and abusive lending practices? Which non-banks should also be subject to an affirmative obligation? And what complementary legislative and regulatory changes are needed to promote the broader goal of reinvestment in underserved communities?

AFFIRMATIVE OBLIGATION—A RECORD OF SUCCESS

While CRA may not be the sole reason that banks have made progress in serving lower-income communities, CRA has shown that an affirmative obligation can create a win-win for the institutions, their customers, and their communities. With this regulatory mandate, banks found good business opportunities, borrowers (including individuals, businesses, and real-estate development projects) gained new access to credit, and communities have been better able to develop and thrive. By following good underwriting practices, banks have demonstrated that loans in these communities can perform well, thereby helping to attract additional capital and competition, creating a virtuous circle.

CRA has created a cadre of bankers who recognize the business potential of lending to low- and moderate-income neighborhoods prudently and profitably. They have learned how to collaborate with community-based organizations, each other, and with government to provide, for example, real-estate loans for affordable housing and community economic development, which were previously avoided due to their complexity and modest size as well as to possible discrimination. Prodded by CRA, banks helped nurture and sustain the growth of a whole new industry of community-development financial institutions (CDFIs) that use their specialized knowledge and lower operating costs to serve low- and moderate-income communities more effectively than a bank can directly.

The current financial crisis and a prolonged recession could well reverse all

Government Lifeline? ACORN stages a protest in front of the Federal Reserve Bank in Doral, Florida.

J. PAT CARTER / AP IMAGES

past progress, however. Less affluent communities are particularly vulnerable to the combination of job losses and mortgage foreclosures. Meanwhile, banks are focused internally on cutting cost, trimming every possible product and service that cannot turn a profit, and improving the credit performance of their portfolios through much tougher underwriting standards. The need for financial-sector reform and for public policy to be responsive to the potentially disproportionate impact on these communities is urgent.

CRA misses a lot of the action because it only covers banks. The law needs to be extended to cover banks' competitors.

WHAT IS THE BEST WAY to revamp CRA and utilize other laws with complementary policies?

Bring competitors into the fold. At their peak, over 50 percent of sub-prime home-mortgage loans were originated by non-banks, including independent mortgage banks, many of which are now gone. Regulating just the banks did not work. Bankers and community advocates agree that all the key players in the market should be subject to the same rules and regulations and to the same public scrutiny as banks. In fact, consideration should be given to including an affirmative obligation in any comprehensive legislative reform of the home-mortgage markets. Taking advantage of such legislation would both ensure fair and equal coverage of all players in that market and allow CRA to focus on other areas of importance for the well-being of low- and moderate-income communities.

Make CRA less complicated and more effective. As a regulatory process, CRA requires the grading of a bank's performance with the two possible passing grades being satisfactory and outstanding. Banks with lower ratings can be denied approval for business objectives such as permission to merge or make acquisitions. The CRA review also offers a target for activist groups seeking leverage on bank-lending policies. As the regulators have tried to accommodate the concerns of activists and others, the process has become more and more complicated and cumbersome with exams for a large, national bank taking 18 months or more to complete. By the time the results are in, they are often too late to have an effect on the bank's business strategy for its next CRA exam.

Focus on community development. In addition to expanding coverage to non-banks, CRA reform needs a better focused evaluation of banks. While community-development loans and services are critical to helping low- and moderate-income communities to thrive, they are undervalued by CRA today. They should get more credit. Loans for affordable housing and community economic development only count for extra credit, and community-development services appear to have a weight of only about 5 percent toward the bank's composite CRA score. Also, loans that are made at below-market interest rates—especially if at a rate below the bank's internally charged "cost of funds"—should receive more credit than those made at market rates. These loans can be of particular value to CDFIs.

Emphasize quality, not just quantity. A greater emphasis on community-development lending also suggests the need to bring qualitative judgments back into the rating process. A well-intentioned CRA reform enacted in 1995 emphasizes outputs—"production over process." But today's greater reliance on sheer numbers has undervalued such important factors as technical assistance devoted to making deals happen and pricing concessions needed to make deals work. CRA should count the extra efforts the bank makes to assure that credit actually flows to communities that would otherwise be underserved. Examiners need to be both trained to ascertain which loans had a significant impact on the community and would not otherwise have been done, and empowered to give these loans extra weight.

Acknowledge differences among banks. Today, banks with only a local presence, but with assets greater than $1 billion, are examined under the same rules as national mega-banks; they are subject to the same tests on the same products and services. CRA should allow more variation in the types of skills, knowledge, and systems that are typical of banks of different sizes. For example, large national banks should get credit for investing in national funds that help improve the flow of capital to multiple local jurisdictions. Similarly, regulators should adjust criteria to local conditions. For example, Cleveland may be more in need of replacing surplus properties with urban amenities (green spaces, for instance) whereas New York continues to face a shortage of affordable housing. The regulators could give a bank the option of being judged under the standard rules or based on a set of tests that are more locally tailored.

Avoid promoting destructive competition. Overemphasis on sheer loan volume can cause banks to fight over market share, purely for regulatory credit. The goal of CRA is to encourage banks to look harder to expand their lending opportunities in low- and moderate-income communities, not to lower price or credit quality in a desperate attempt to steal market share from one another. More generally, all of the CRA examination criteria should be reviewed to assure that the banks truly serve the law's broad goal. Some are not worth the trouble and take limited resources away from more important measures. Others have unanticipated or perverse consequences.

Addressing foreclosure prevention. Several million American families will lose their home in the next few years, whether because of the exploding costs of sub-prime loans or because of household income losses in the recession. To date, the administration's policy of giving financial rewards to banks for modifying loan terms has had only limited incremental impact. For CRA itself to make a difference, it would have to offer specific and significant CRA credit for cooperating with the loan-modification program. Public-policy initiative may well need to become more robust before the foreclosure crisis is solved.

BEYOND CRA

Overburdening CRA with new requirements and expanding it to new industries, products, and situations can, paradoxically, defeat the larger purpose if the result is to dilute CRA's effectiveness or lead us to ignore other needed policy tools. Arguably, if the Home Ownership Equity Protection Act of 1994 had been enforced, with its requirement of sound underwriting standards even for non-depository institutions, there would have been no sub-prime catastrophe. If the political will is not present to enforce other existing laws, expanding the reach of CRA is a poor substitute and may backfire.

Use better and more targeted subsidies. The rewards and sanctions of CRA may not be enough to promote the desired flows of capital to credit-starved communities whether through specialized community-development financial institutions or via direct loans that may have additional risks, are more costly to service, and are not conventionally profitable without additional subsidy. While CRA has sparked some innovation and experimentation by banks, it has rarely, if ever, been able to induce a bank to market and produce at scale products and services that lose money either because of high production costs or an inability to set a price sufficiently high. Nor has CRA had much effect on the amount of funds a bank allocates for philanthropic purposes although it may have raised the proportion going to community development. If we want to expand the overall resources available to less affluent communities in a way that succeeds, we need to recognize that this enterprise will sometimes require direct subsidies as well as regulatory carrots and sticks.

The types of incentives that CRA can offer, even once strengthened, have only a limited ability to induce banks to undertake activities that do not meet their minimum profitability hurdles. The U.S. Treasury has a program called First Accounts, which subsidizes the expenses of helping lower-income people who have no bank accounts to move into the financial mainstream. However, the program has been woefully underfunded. Sometimes, subsidizing the extra administrative, underwriting, and counseling costs, as well as a shallow subsidy of interest rates, is more effective than regulatory pressure in getting banks to provide services that are otherwise not cost-effective for the bank.

Fix other laws that fight discrimination. Some advocates have called for the additional public disclosure of the race and gender of small-loan applicants as well as more detail on home-mortgage loans, including an applicant's credit score. While the purpose of unmasking patterns of discrimination is laudatory, especially given the apparent persistence of racial targeting in sub-prime lending, researchers have estimated such disclosures could allow 80 percent of the personal data to be matched to a specific person by using other data sources from credit records. Strengthening and effectively enforcing existing fair-lending laws may be a better approach than adding more requirements to CRA and risking disclosures that could violate personal privacy. If the issue is affirmative obligation, then it may be better to add it to the anti-discrimination laws than to enmesh the CRA itself in the process of investigating discrimination, which often requires reviewing individual loan files, a process that seems best done on a confidential basis.

Cover other financial products and services. An affirmative obligation might also be appropriate for non-bank financial products that are critical to the well-being of a community. Insurance is one example often cited. For these, the same set of questions should be addressed before applying an affirmative obligation. What particular products or services are at issue? Is the community underserved with regard to them? Would the benefits (private and society-wide) of providing them exceed the costs? If so, what would be the best way to cover all the firms playing in that particular market? If there

LOANS GONE BAD

Sub-prime adjustable-rate mortgages have the worst default record.

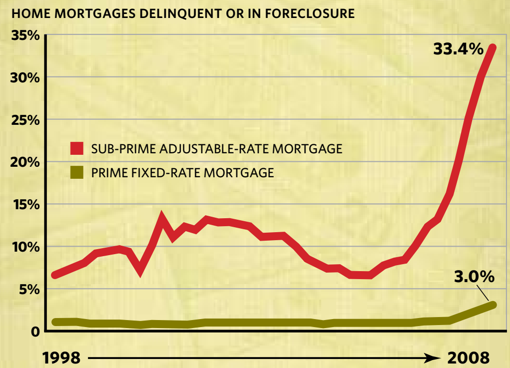

CHART SOURCE: MORTGAGE BANKERS ASSOCIATION / MILKEN INSTITUTE is a problem with profitability, would monetary incentives be preferable? The clearer the answers are to these questions, the more effective the legislation will be in helping communities.

The brilliance of CRA was its brevity and simplicity. It required affirmative outreach to communities and left the details to regulators and to interactions between banks and community groups. While this approach left room for innovation, it also expanded expectations beyond what CRA alone could accomplish. To be truly effective going forward, CRA needs more focus on community development; its regulations need more latitude with clear but flexible criteria, and laws that complement CRA should be strengthened. **TAP**

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What Does Financial Capital Owe Society?

Corporate social responsibility is a worthy goal, but it's no substitute for regulation, subsidy, and government sponsorship of social institutions.

BY BARRY ZIGAS

The idea that private enterprise should be harnessed to the creation of social capital is an old claim given new resonance by the financial crisis. After beggaring millions of people and threatening the global economy with ruin, banks and other credit providers surely have an obligation both to run their businesses soundly and to meet a higher standard of social responsibility. While some argue this could hobble, distract, or damage corporate focus on the bottom line, let's be clear. It was not an excess of attention to social needs that caused the near total collapse of the world's financial system but almost every other kind of excess.

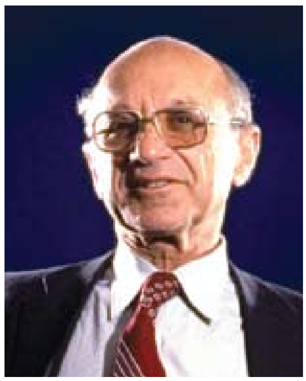
Milton Friedman defined the classic position against corporate social responsibility in an oft-quoted 1970 *New York Times Magazine* article, where he stated flatly that a corporate executive's responsibility is "to conduct the business in accordance with [shareholders'] desires, which generally will be to make as much as possible while conforming to the basic rules of the society." Friedman continued that "there are no values, no 'social' responsibilities in any sense other than the shared values and responsibilities of individuals."

Companies, in other words, should stick to their business. Any diversion erodes shareholder value, diminishes focus on what capitalists do well, and arbitrarily bends private investment to pursue public goals, often without accountability for either the choice of goals or the efficacy of their pursuit.

But corporations are creatures of public legislation and regulation. They enjoy limited liability, certification by the Securities and Exchange Commission (SEC), which helps them float stock, and a variety of other public investments that help them do business. Banks, as specialized institutions, have an even more extensive other layer of public benefits in ordinary times, as well as emergency aid in a crisis. These include access to credit from the central banking system, examination and certification of soundness, and deposit insurance. And in the current crisis, government has also used trillions of dollars of public funds to prop up banks' shaky balance sheets and guarantee the institutions' debt, while the Federal Reserve has opened its spigots to provide liquidity as necessary.

THE CONTENTION THAT a corporation owes society something in return requires closer analysis. Some of the benefits that society expects are relatively cost-free or are spread so uniformly across business sectors that they do not impose noticeable costs. But in other cases, pursuing social goals may turn out to be less profitable or to take a measurable bite out of the company's total return.

Many of business' reciprocal obligations to society are fairly basic. As beneficiaries of government's basic civil-society functions, like national defense, corporations are expected to pay taxes and follow norms of good behavior. They may not commit fraud. We do not allow them to deny employment, credit, or other benefits on the basis of race, gender, national origin, age, or sexual orientation. Labor's right to organize and negotiate in its own interests generally is well established, though often breached in practice. Market forces alone cannot be left to assure safety in automobiles or in the air. More narrowly, the Community Reinvestment Act requires banks that take deposits out of communities to give something back, in the form of credit to low- and moderate-income as well as affluent borrowers.



Nothing Owed: According to free-market guru Milton Friedman

EDDIE ADAMS / AP IMAGES

Corporations didn't always accept that these citizenship responsibilities were theirs. Some still chafe at them. But they largely are accepted, at least in broad principle. Some, although not all, of these benefits impose costs on corporations. But they are the necessary