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The Seeds are Sown

Introduction

It is impossible to understand and appreciate the extent of subprime lending and its contribution to the global financial crisis without an analysis of the origins of such lending and the operations of the US mortgage market, especially from the mid-1990s to the time when the bubble finally burst in 2008. The period was dominated by the “American Dream of Homeownership” to which all actors in the mortgage market subscribed, even if it was only a matter of paying lip-service to the dream. What marked the difference between this era and the preceding ones was that successive Presidents espoused the dream, but did little to make it a reality.

What happened subsequently was that politicians recruited all the federal housing agencies to serve the end of “home ownership for all.” This book will explore the ways in which every aspect of the market was subsumed to that purpose; how a combination of the contribution of all those agencies, working together with the banks and other players who grabbed money-making opportunities, created a huge pool of subprime mortgages. It was a heady mix of good intentions, the reasonable aspiration of owning one’s own home, negligence, greed, fraud on the part of some lenders, some government agencies, and even borrowers as well, driven by politicians of every hue. These all combined to encourage all the players to take on risks, which they either did not understand, or which they thought they could handle in the good times. The good times did not last.

The Clinton era

The crisis arose out of laudable political aims and aspirations: to extend the American dream of home ownership. “You want to reinforce family values in America, encourage two-parent households, get people to stay home? Make it easy for people to own their own homes and enjoy the rewards of family life and see their work rewarded. This is the big deal. This is about more than money and sticks and boards and windows. This is about the way we live as people and what kind of society we’re going to have.” These were the widely held ideals expressed by President Clinton when he announced the National

Homeownership Strategy in June 1995, which was the beginning of the affordable homes era. These ideas had not been plucked out of the air: much research lay behind them.¹

The National Homeownership Strategy brought together fifty-six leading organizations concerned with mortgages, affordable home ownership, community activists, state housing provision, government departments and many others as “Partners in the American Dream,” including the American Bankers Association; America’s Community Bankers; the Federal National Mortgage Corporation, and the Federal Home Loan Mortgage Corporation (commonly known as Fannie Mae and Freddie Mac respectively); the National Association of Realtors; the National Council of State Housing Agencies; the Neighborhood Reinvestment Corporation; and the US Department of Housing and Urban Affairs.

Amongst the Action Points included in the program under the strategy of reducing down-payment and mortgage costs, especially for low- and moderate-income home buyers, were more flexibility in down-payment requirements to include “public subsidies or unsecured loans;” counseling to accompany mortgage financing with high loan-to-value ratios; and flexible mortgage underwriting criteria. The actions of Fannie Mae and Freddie Mac in introducing affordable loans for home purchase, loans requiring only 3% from the purchaser when an additional 2% is available from other funding sources such as gifts, unsecured loans and government aid, were commended in the National Strategy announced in May 1995.

The aim was quite explicit. “Since 1993,” the President said, “nearly 2.8 million households have joined the ranks of America’s homeowners, nearly twice as many as in the previous two years. But we have to do a lot better. The goal of this strategy, to boost homeownership to 67.5% by the year 2000, would take us to an all-time high, helping as many as 8 million American families to cross that threshold ... and we’re going to do it without spending more tax money.”² The reference to not spending any more tax dollars is significant. President Clinton did make further cuts in the housing budget, especially for public housing: here, changes involved the replacement of high-rise concrete blocks with low-level scattered housing. However, the total stock for public housing fell during that period, as did new units for subsidised rental accommodation,³ and this must also be considered part of the background against which the political push for affordable housing should be assessed.

Racial discrimination and home ownership

The issue of racial discrimination in housing, and hence the need to increase home ownership in low-income and underserved areas, had already come to the fore when the Federal Reserve Bank of Boston published a study entitled

“Mortgage Lending in Boston: Interpreting HMDA data.”⁴ Based on the Home Disclosure Act data for 1990, together with their own survey, the authors concluded that the data showed substantially higher denial rates for black and Hispanic applicants. Even high-income ethnic minorities, the authors claimed, were more likely to be turned down than low-income whites. They reached this conclusion after finding that the higher denial rate for minorities is accounted for, in large part, by such applicants having higher loan-to-value ratios and weaker credit histories than whites; they are also more likely to seek to purchase a two- or four-unit property than a single family home. A black or Hispanic applicant in the Boston area is roughly 60% more likely to be denied a mortgage than a similarly situated white applicant. “In short,” the paper concludes, “the results indicate that a serious problem exists in the market for mortgage loans, and lenders, community groups and regulators must work together to ensure that the minorities are treated fairly.”⁵ The authors rightly state that “this pattern has triggered a resurgence of the debate on whether discrimination exists in mortgage lending.”

The study did more than trigger a debate; it led to increased community activity and encouraged politicians to use legislation and bank lending to achieve social aims. Groups such as the Association of Community Organizations for Reform Now (ACORN) and many other local groups engaged in direct action, such as arranging sit-ins in bank branches until banks agreed to lend more, entering into partnerships with local groups to lend to low-income areas, or demanding that banks publish more of the information they were already required to provide for the authorities under the Home Mortgage Disclosure Act, 1975.

The article also sparked an intense political debate, conducted in the media, and had a major influence on public policy, largely because it came from an important government agency and, as such, was bound to capture public attention. Its central claim did not go undisputed. It led to an avalanche of academic papers, some arguing that the conclusions were based on incomplete data or; that there were serious errors in the data, which, when removed, also removed the evidence supporting the discrimination hypothesis;⁶ that several alternative model specifications perform better than the logit regression models used for the Boston study in terms of various econometric performance measures, and do not support the conclusions;⁷ or that the model uncertainty can be eliminated using Bayesian model averaging (the result of the latter indicates that race has little effect on mortgage lending.⁸) Another paper rejected the Boston study’s market level model, arguing that the “standard” Boston model can only be used, at best, on the basis of a bank-specific analysis, based on its own particular lending guidelines.⁹

Many studies followed the Boston one in focusing on denial rates. Others argued that this was entirely the wrong approach: they have “not determined the profitability of loans to different groups ... A valid study of discrimination

in lending would calculate default rates, late payments, interest rates and other determinants of the profitability of loans” and that “failure to do so is a serious methodological flaw.”¹⁰ Still other analyses indicated that black households have higher default rates, suggesting that differences in defaults or transaction costs may explain the results.¹¹ The wide range of criticisms of the Boston analysis suggests that it may not have been the most reliable foundation on which to build public policy, but neither politicians nor regulators wished to be perceived as being unconcerned about such widely reported racial discrimination in lending.

Lawrence Lindsay, then a member of the Board of Governors of the Federal Reserve, having been informed of numerous problems in the Boston study said, “The study may be imperfect, but it remains a landmark study that sheds an important light on the issue of potential discrimination in lending.”¹² This, despite the fact that the vital element missing in the HMDA data is a lack of information about the credit history of the borrower and the difficulties as time went on in tracking default rates. These are both issues regarding data which will be explored at a later stage.

Changing the underwriting standards

Given that the debate about racial discrimination began at the Federal Reserve Bank of Boston, it is small wonder that it was followed by “Closing the Gap: A Guide to Equal Opportunities Lending” with a foreword by Richard Syron, President and Chief Executive, in which he quoted approvingly Lawrence B. Lindley, a member of the Board of the Federal Reserve System: “The regulatory issues in the 1990s will not be limited to safety and soundness, but will increasingly emphasise fairness: whether or not the banks are fulfilling the needs of their communities.” Syron states that the Federal Reserve Bank of Boston have developed a comprehensive program for all lenders who wish to ensure that all their borrowers are treated fairly, and to “expand their markets to reach a more diverse customer base.” Lenders should review every aspect of their lending practices, staffing and training to ensure that no part of the process is “unintentionally racially biased,” since underwriting guidelines are historically based on “data that primarily reflect nonminority mortgage loan participants.”¹³ In particular, the lack of a credit history “should not be seen as a negative factor,” since certain cultures encourage a “pay-as-you go” approach. Instead a willingness to pay debt promptly should be assessed through a review of utility, telephone and medical bills, and rent payments; and past credit problems should be reviewed for extenuating circumstances.

Similar considerations should apply to employment history, where lenders should focus on the applicant’s ability to maintain or increase his or her income level. Interestingly enough, the Guide noted that Fannie Mae and Freddie Mac

(of which more later) would accept as valid income sources: overtime and part-time work; second jobs (including seasonal work); retirement and Social Security income; alimony and child support; Veterans administration benefits; welfare payments and unemployment benefits. Together with CRA-lending (see below), these recommendations would inevitably weaken underwriting standards, as thrifts and commercial banks sought to increase lending based on this guidance.

Using the Community Reinvestment Act (CRA)

All of these issues lay behind the development of the National Homeownership Strategy as described in an Urban Policy Brief prepared by the Housing and Urban Development Department in 1995. The Strategy was described as an unprecedented public-private partnership, designed to increase home ownership to a record level over the following six years. Home ownership was described in romantic terms: “The desire for home ownership is deeply rooted in the American psyche. Owning a home embodies the promise of individual autonomy and of material and spiritual well-being ... In addition to its functional importance and economic value, home ownership has traditionally conveyed social status and political standing. It is even thought to promote thrift, stability, neighborliness and other individual and civic virtues.” The brief then refers to the bi-partisan support for Federal policies designed to encourage home ownership from Presidents Herbert Hoover to Ronald Reagan.

The problem that President Clinton sought to address was the decline in home ownership rates beginning in the 1980s, falling to 64.1% in 1991. The decline was sharpest amongst those for whom the possibility of buying their own homes has always proved more difficult such as low-income families with children (from 39% to 27%). Rates stagnated at about 43% for blacks, but dropped from 43% to 39% for Hispanics between 1980 and 1991. During the late 1960s and the 1970s, it was argued that banks would not lend to specific neighborhoods regardless of the residents’ creditworthiness, and that these areas were red-lined largely because of the residents’ race, ethnicity and income. Various Acts had been passed to reduce discrimination in the credit and housing markets, including the Fair Housing Act, 1974, the Equal Credit Opportunity Act, 1974 and the Home Mortgage Disclosure Act, 1975. The Community Reinvestment Act, 1977 (CRA) was also designed to encourage depository institutions to meet the credit needs of the communities in which they operate, including low- and moderate-income neighborhoods “in a manner consistent with safe and sound operations.” The CRA applies to all federally insured banks.

To deal with all of these issues, President Clinton’s approach to the extension of home ownership, especially in low-income and underserved

areas, which would greatly assist with the problem of racial discrimination, was two-pronged: the introduction of the Strategy; and the amendments to the regulations under the Community Reinvestment Act as a further step after the Federal Housing Enterprises Safety and Soundness Act, 1992, which, *inter alia*, requires the existence of the Federal National Mortgage Corporation and the Federal Home Loan Mortgage Corporation (commonly known as Fannie Mae and Freddie Mac respectively.) Fannie Mae and Freddie Mac had to meet annual percent-of-business goals established by the Housing and Urban Development Department (HUD) for three categories: low and moderate income; underserved; and special affordable.¹⁴ Clinton regarded the CRA changes as one of the highlights of his presidency:

One of the most effective things we did was to reform the regulations governing financial institutions under the 1977 Community Reinvestment Act. The law required federally insured banks to make an extra effort to give loans to low- and modest-income borrowers, but before 1993, it never had much impact. After the changes we made, between 1993 and 2000, banks would offer more than \$800 billion in home mortgage, small-business and community development loans to borrowers covered by the law, a staggering figure that amounted to well over 90% of all loans made in the twenty-three years of the Community Reinvestment Act.¹⁵

When Congress passed the Act in 1977, it was built on the straightforward proposition that deposit-taking banking organisations have a special obligation to serve the credit needs of the neighborhoods in which they maintain branches. At the time of the passing of the Act, banks and thrifts originated the vast majority of home purchase loans. Concerns had been expressed not only about racial discrimination, but also about the deterioration in the condition of many of America's cities, especially in low-income neighborhoods, and many believed that this had been caused by limited credit availability, blaming the mainstream depository institutions for their alleged unwillingness to lend to low-income neighborhoods, despite the presence of creditworthy consumers.

The initial focus on the areas in which the CRA-registered institutions maintained branches made sense because of the restrictions, a ban, in fact, on interstate banking and branching activities which were limited to the geographic scope of mortgage-lending operations. Not only were banks prevented from engaging in interstate banking, but intrastate branching was also severely restricted. Other factors included an underdeveloped mortgage market, the lack of a comprehensive national credit reporting system, expensive credit evaluation methods, and unlawful red-lining.

The 1977 Act required insured depository institutions to serve the "convenience and needs" of the communities in which they are chartered to do business, including meeting their credit needs. The Bank Holding Act, 1958 already required the Federal Reserve Board, when considering proposed acquisitions by banks or bank holding companies, to consider how well they

were meeting community needs, a factor which became more important under the Riegle-Neal Act of 1994.

Until the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) came into force in 1989, CRA examinations led to a confidential report and rating, provided only to the bank or thrift. Under FIRREA, the regulators were obliged to make the ratings public and provide written performance evaluations, using facts and data to justify the agencies' conclusions. These were sometimes used in the ways described below, which were perhaps not envisaged in the Act.

The Act itself directs the federal regulators of federally insured commercial banks to encourage their regulated institutions to meet the credit needs, in particular, of low- and moderate-income neighborhoods in a way consistent with "safe and sound" operations, the latter perhaps being a somewhat neglected aspect of the assessment. It was because of the perceived ineffectiveness of the CRA in meeting these requirements, and its apparent failure to ensure that the credit needs of the minorities were met, that the new regulations of which Clinton was so proud were issued at his request by all four of the then federal banking regulators: the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS).

The regulations were issued in 1995 and were designed to ensure that banks met the credit needs of the low- to moderate-income areas; that is, any area in which the bank had a branch or an ATM. This, as we have seen, is partly because banks were confined to a particular state and the areas in which they had permission to open a branch. The income area was also strictly defined in terms of "census tracts." In the 1990s, such tracts consisted of between 2,000 and 8,000 people, designed to be relatively permanent and stable in terms of population characteristics, economic status and living conditions.¹⁶ The income levels in a tract could be determined, and banks were "encouraged" to increase lending to those in low-income areas (below 50% of the area median income) and to those on moderate incomes (between 50% and 80% of the area median income).

Banks were required to define their assessment area and ensure that it was updated annually to include any census tract in which a branch or an ATM had been provided. They were free to define one or more assessment areas, but each assessment area must consist of one or more metropolitan statistical areas and include the geographical areas in which the bank had its main office, branches or deposit-taking ATMs, as well as the surrounding areas in which the bank had originated or purchased a substantial part of its loans, including home mortgages. They had to use the areas as defined by the Office of Management and Budget and the Census in force at the beginning of the calendar year, and had to include the whole geographical area. This was designed to ensure that the bank could not select boundaries which reflected illegal discrimination or arbitrarily excluded low- and moderate-income areas.

The basis of the evaluations varied according to the size of the bank: those with assets of \$1,061bn faced a lending test, an investment test and a service test. Lending is assessed on both qualitative and quantitative factors and the outcome accounts for 50% of the bank's overall CRA rating. Investment benefitting low- and moderate-income individuals and neighborhoods or rural areas, and services to the entire community are reviewed, with each accounting for 25% of the rating. In a 2002 amendment, financial institutions with assets between \$265m and \$1,061bn, "designated intermediate small institutions," are evaluated on their record of lending in low- to moderate-income areas and low-income individuals in the institutions' assessment areas. The assessment includes a community development test but allows banks flexibility in allocating their resources where they will produce the greatest benefit. Those institutions with less than \$265m are evaluated primarily on their lending performance in their communities, including low- to moderate-income areas and populations, but are not expected to engage in complex and expensive community projects.

To those outside America, such rules will no doubt appear extraordinarily bureaucratic. However, in the context of local banks confined within a state and often within a limited number of counties, the emphasis on geographical location defined in this way made it possible for regulators and others to check on the loans the banks made in any one year, using the assessment areas as defined by the bank. Banks had to keep full records in machine-readable form as prescribed by the regulatory authorities of all their small business and small farm loans, mortgages and consumer loans. Under HMDA, banks with offices in metropolitan areas had to report annually and publicly, itemising each housing-related loan originated or purchased during the year, including the location of the loan and the borrower income.

In a nod to the changing structure of banks, the 1995 regulations did allow banks and other regulated institutions to include lending by mortgage companies or subsidiaries. These changes gave each institution the discretion to exclude or include the activities of affiliated mortgage companies in the CRA examination for specific assessment areas. This was a recognition on the part of the regulatory authorities that some mortgage company affiliates specialized in serving lower-income markets, whilst others wished to serve a larger market; however, it is possible that at the same time it may have weakened the CRA's inducements to expand lower-income lending by allowing institutions to select the combination of reporting that would produce the most favorable lending record. In addition, the revised lending test, which gives lenders credit for certain mortgage loans regardless of the characteristics of the area in which loans are made, represented a move away from the spatial focus of the CRA, but that was not the immediate effect.

The financial institution then had to pass various tests to achieve the most desirable 'outstanding' rating, if it demonstrated responsiveness to credit

needs in its assessment areas. That would be shown if “there is an excellent distribution ... of loans amongst individuals of different income levels; an excellent record of serving the credit needs of highly disadvantaged areas in its assessment areas, including low-income individuals ... and extensive use of innovative or flexible lending practices in a safe and sound manner to address the credit needs of low- or moderate-income individuals.”¹⁷ The rule also established a “performance context. An institution’s performance under the tests and standards in the rule is judged in the context of information about the institution, its community, its competition and its peers.”¹⁸

To encourage such lending, the regulators continued to use publicity from which, during the long consultation period of some two years altogether, the industry requested a “safe harbor” from the activities of community groups, which they were not granted. More important from the banks’ point of view was the requirement to have at least a “satisfactory” rating (or better, an “outstanding” rating) as a result of the CRA examination, if a bank was to apply to its regulatory authority for permission to relocate a home office or to open or relocate a branch, to merge with or acquire another insured depository institution, to convert an insured bank to a national bank charter, or to assume the assets or liabilities of another regulated financial institution. In addition, the assessment of the bank would be adversely affected if there was evidence of discriminatory or other illegal credit practices; the regulator would also take into account any policies and procedures that the bank had in place to prevent such practices.

A bank then had to make available to the public the CRA assessment together with detailed information, such as the number and location of its branches, services generally offered at the branches, and, for banks other than small banks, the number of loans in each income category and the location of those loans in the bank’s assessment area, plus the information required under the Home Mortgage Disclosure Act. Large banks needed an “outstanding” rating to excel against their competitors. The regulatory authorities would also take into consideration the public response, including responses from ACORN, the Neighborhood Assistance Corporation of America (NACA), and other consumer advocacy groups. These developments, for which ACORN in particular had long argued, provided such groups with all kinds of new opportunities. Previously, they had used strong-arm tactics, such as sit-ins in bank branches, disrupting tellers’ queues, annual meetings, and targeting executives’ homes. The amendments to the CRA meant that they would be able to use public information about a bank’s CRA rating to force more lending to minorities and low-income families. Many banks caved in and entered into partnerships, promising to spend millions of dollars over the years to various projects. Meanwhile, the organisations were able to cash in, as they received huge grants for mortgage counseling and financial education. NACA apparently decided with what it claimed was delegated underwriting

authority from banks to arrange mortgages for low-income families and expected to close 5,000 mortgages in 2001, earning a \$2,000 origination fee on each.¹⁹ ACORN focused on providing counseling and training for would-be borrowers.²⁰

It is arguable that the CRA and its 1995 amendments became less relevant as the decade progressed, since banking changed in ways which were not envisaged in the Act. These included developments in banking technology, automated mortgage underwriting, telephone banking and the development of ATMs. Banking organisations operating outside their assessment areas expanded rapidly and comprised the fastest-growing segment of the residential mortgage market during that period. As a result, between 1993 and 2000 the number of home purchase loans made by CRA-regulated institutions *in their assessment areas* fell from 36.1% to 29.5%.

The regulatory structure that was in place when the CRA was enacted, in the late 1970s and subsequently, imposed many restrictions on financial institutions in terms of the types of products and services they could offer, the geographical areas in which they could operate, and the range of interest rates they could offer depositors or charge borrowers. In addition, strict chartering requirements raised the cost of setting up new financial services companies. “Redlining may have become a red herring, drawing attention away from the effectiveness of market forces in breaking down the types of financial barriers prevalent when the CRA was enacted.”²¹ Lending to low- and moderate-income families in underserved areas was not going to be left to market forces and developments in banking. Instead, new legislation coupled with the CRA would provide more tools for community and housing advocacy groups to ensure and some would say, force, some banks to lend to such families, and others to embrace the opportunity.

The implications of the Riegle-Neal Interstate Banking and Branching Act, 1994

Amongst its other effects, this Act increased the importance and value of the “outstanding” rating for banks. The amendment Act enabled full nationwide banking across America, for the first time and regardless of state law, after it came into full effect on June 1, 1997. It allowed branching through acquisition only, which means that a bank must acquire another bank and merge the two structures in order to operate across state lines, unless there existed a reciprocal agreement between states. The states had the power to allow a bank to open a branch in another state without the necessity of acquiring another bank to allow them to open a branch. The Act also allowed states to “opt out” of interstate banking by passing a law to prohibit it before June, 1997, but Texas and Montana were the only two states to do this. The first stage

was agreements between states, but finally by 1997, the Act was signed into a law ratifying agreements between states, the FDIC and the Federal Reserve allowing for “seamless” supervision for state-chartered branches with branches across state lines.

It is in this context that the importance of the CRA amendments to the regulations must be seen, as Chairman Ben Bernanke pointed out in a speech in 2007. The 1994 Act was followed by “a surge in bank merger and acquisition activities ... As public scrutiny of bank merger and acquisition activity escalated, advocacy groups increasingly used the public comment process to protest bank applications on CRA grounds. In instances of highly contested applications, the Federal Reserve Board and other agencies held public meetings to allow the public and applicants to comment on the lending records of the banks in question. In response to these new pressures, banks began to devote more resources to their CRA programmes. Many institutions established separate business units and subsidiary community development corporations to facilitate lending that would be given favorable consideration in CRA examinations.”²² The public, of course, already had access to information about the distribution of loans, since banks were required to publish it. Community action groups often used such publicity to “encourage” banks to lend to such areas: indeed, there are examples of banks funding various housing and other development projects or financing community organisations in order to avert bad publicity. These had become more important factors in the context of the Riegle-Neal Act.

The “surge” in mergers and acquisitions

The “surge” in mergers and acquisitions to which Chairman Bernanke referred changed the whole structure of American banking, both within the USA and globally. At the end of 1996, and before Riegle-Neal came into force, the largest American bank was Chase Manhattan Corp., New York, then ranked seventeenth in the world by assets (\$333.8 billion), followed by Citicorp, New York, ranked twenty-sixth, then BankAmerica Corp., San Francisco and J.P. Morgan & Co. Inc., New York. At that time, six of the ten largest banks in the world were Japanese. By the end of 2000, the largest banking group in the world was Citigroup at just under \$1 trillion, and another two of the top ten banks in terms of asset size were American banks: J.P. Morgan Chase & Co., New York (\$715,348,00) and Bank of America Corp., Charlotte, N.C.; a further nineteen significant acquisitions took place between 1998 and 2001, which involved extending the lines of business, such as acquiring trust services, mortgage banking or servicing, securities brokerages and investment advisory. Some of the acquisitions followed the repeal of Glass-Steagal by the Gramm-Leach-Bliley Act in 1999. Overall, the number of banks fell from 14,451 in

1982 to 8,080 in 2001. The total number of branch offices almost doubled during the same period, from 34,791 to 64,087.

Acquisitions and mergers did take place prior to 1997, when the Act was fully implemented. Based on an approach which aggregates all subsidiaries of the target banking organisation and views them all as one acquisition, dating from the completion of the transaction, a study by the Federal Reserve Bank shows that between 1994 and 2003, 3,517 deals were completed and that the target (acquired organisations) had \$3.1 trillion in total assets, \$2.1 trillion in total deposits, and 47,283 branch offices. The three largest deals of the entire ten-year period (ranked by asset size of the target) all took place in 1998, the year marked by the greatest volume of merger activity. Three other deals among the fifteen largest also took place in that year. Fifteen banking organisations were the acquirers in the twenty-five largest acquisitions. Four of these, First Union, Fleet and its successor FleetBoston, Nations Bank and Washington Mutual, were each of the acquirers in two of the top twenty-five. Two other banks, Firststar and Chemical (and its successor, Chase Manhattan), were each of the acquirers in the top twenty-five. The targets in many of the biggest deals were banks with large retail operations, allowing an expanded service area and greater penetration of established service areas, as well as a large retail customer base.²³

Mergers and acquisitions are generally the only way to extend the retail customer base. The market share of the fifty largest bank holding companies actually declined from 71% in 1990 to 68% in 1999, reflecting their relatively low internal growth on a pro forma basis. In contrast, the market share of the top fifty in unadjusted terms increased steadily during the 1990s and underwent an especially significant jump in 1998, after the series of mega-mergers referred to above dramatically increased the size of several of the largest bank holding companies. This showed that the largest bank holding companies increased market share through M&As, and that internal growth was an inconsequential factor. It is possible that, with the aim of reducing excess capacity, the consolidated banks removed overlapping operations and became smaller in the short run; lowering costs and increasing efficiency would then enable them to outgrow competitors and thus increase market share. All of these changes meant that the structure of the banking industry changed dramatically during the 1990s, and would change again with the Gramm-Beach-Bliley Act.²⁴

The importance of CRA ratings

The result of the regulations and the surrounding publicity led banks to focus on those activities which counted towards the rating, regardless of their impact on strengthening communities; or, as one commentator put it: "It's the

rating, stupid!”²⁵ When a bank wishes to merge with another bank (or open an additional branch or branches) it must submit an application to its federal regulator. Various factors are taken into account, including the bank’s record in serving the convenience or needs of the communities under the CRA. A merger application can be denied or delayed based on poor performance in meeting any of the factors considered in the application process, including CRA ratings. Denials of merger or acquisition applications are rare, but delays may occur while the bank answers various questions about its past CRA performance or makes specific commitments to improve its performance. A conditional approval may also be given for a merger or an acquisition, but a bank is required to take steps to remedy the deficiency and improve its rating. The public and community organizations also participate in the process. That is one reason why banks are concerned with the CRA ratings, since delays in planned mergers and acquisitions are costly and may prevent the bank from developing an effective competition strategy. Perhaps because of these and other strategies, based on the Federal Financial Institutions Examination Council (FFIEC) between January 1997 and November 1999, about 20% of all banks received an “outstanding” CRA rating, 79% received a “satisfactory” rating and 1% were advised of their “need to improve” rating.

As a result, CRA agreements are often negotiated between banks and community groups during the merger application process. Banks issue CRA commitments, promising a specific number of affordable home loans and branches in working-class or minority communities.²⁶ According to the US Treasury, the CRA-covered lenders increased home mortgage loans to low- and moderate-income borrowers by 39% from 1993 to 1998, more than twice that experienced by middle- and upper-income borrowers during the same period.²⁷ The report relies on an analysis of HMDA data and does not take into account the purchase of loans.

However, neither Chairman Bernanke nor any other analysts took on board the fact that banks could and did purchase loans in order to manipulate CRA examinations through the buying and selling of loans; and that they were able to do this because the data on loan purchases were not analysed separately from loan originations. In 2004, the regulatory authorities proposed separate tables on originations and purchases of loans, only to abandon this proposal. Originating a loan is a more difficult task in low- to medium-income areas, as it requires advertising, counseling, compliance, and more detailed record-keeping. Purchasing a loan has no, or very little, value to the local community, but is a much less time-consuming process; it is therefore not surprising that it was an option.²⁸ The loan could be purchased and then sold on as a private label mortgage-backed security (MBS), or sold on again to Fannie Mae and Freddie Mac.

Many analysts took the view that it was indeed the case that throughout the 1990s, there was a substantial increase in lending to lower-income populations

and neighborhoods. This was due to a number of factors, such as changes to banking regulations and supervision, increased competition among providers of financial services, favorable economic circumstances and the growing demand for credit, as well as advances in technology allowing for better and cheaper evaluations of borrower creditworthiness. The period from 1991 to 2001 was one in which banks often experienced record profits in a time of unprecedented growth in the economy. This led some to claim that the banks moved into subprime mortgage lending to reap vast profits at the expense of low-income families.

Performance and profitability of CRA-related lending

Increasing suspicions about the possibility of excess profits led Congress to request a report from the Federal Reserve System on the performance and profitability of CRA-related lending. The report was presented to Congress in 2000.²⁹ The authors noted that “little systemic information is publicly available about the delinquency and default (performance) and profitability of CRA-related lending activities.” This is partly because banks identified the origination or purchase of such loans, but did not follow through with the identification up to the point where they were paid off or in default; and also because, although delinquency is more consistently defined and recorded across the industry, default is not. Indeed, there is little agreement on the definition of the latter. The lack of such key agreed definitions is significant and a matter to which it will prove necessary to return.

To deal with these problems, Congress directed the Board to produce a comprehensive study which is focused on (i) delinquency and default rates of loans made in conformity with the CRA, and (ii) the profitability of such lending. This resulted in a special survey conducted by the Board of the largest banking institutions, concentrating on their CRA-related lending, that being considered responsible for the origination of the majority of CRA-related loans. Here the authors of the report had to decide what counted as “CRA-related” loans, so the report itself refers to CRA-related lending as “lending by banking institutions to low-and-moderate income populations, low-and-moderate income areas, small businesses within their CRA assessment area(s) and to lending for the purposes of community development” where the lending is in the first instance referred to home purchases and refinancing.³⁰ In their Economic Commentary on the report, the authors note that their definitions (which covered only federally regulated banking institutions, of course) excluded about half of all lower-income lending done by banking institutions.³¹

Their further notes in the Economic Commentary are also instructive. They found that the focus on home lending in terms of the “relatively narrow group of loans made under the affordable-home-loans programs” often deviated

from the definition of CRA-home loans made by other financial institutions, such as mortgage companies. More important, the frequent inclusion of loans made by banking institutions outside their local communities, and loans made to borrowers with incomes exceeding the lower-income criterion, meant that much of the existing research on performance and profitability is unreliable.³²

However, throughout the report itself, reference is made to affordable lending programmes, which have four distinct elements: targeted groups; special marketing; the application of non-traditional and more flexible underwriting standards; and the proactive use of risk-mitigation activities. Flexible underwriting generally has the following characteristics: relatively low down-payment requirements; higher acceptable ratios of debt to income; the use of alternative credit history information, such as records of payment for rent and utilities; flexible employment standards; and reduced cash-reserve requirements. Some lenders offer reduced interest rates, waive private mortgage requirements, or reduce or waive costs associated with originating the loan. Many of the larger banks, the report states, “have developed new credit products that feature underwriting guidelines that are generally more flexible than those for other products.”³³

The authors set out the way in which they conducted the research, explaining first the data they expected to find. Their survey was restricted to the largest 500 retail banks, because these account for over 70% of one to four family home lending and community development lending, based on their projected total assets as at December 31, 1999. It consisted of 400 commercial banks and 100 savings institutions, ranging in size from about \$870m to \$500bn. The focus should be on one to four family home purchases and refinance mortgage lending, because the banks are able to identify these CRA-related loans at the time of origination or purchase, and so might be able to provide information on their performance and profitability over time, and because the purchases in these categories have enough borrower and geographic information to estimate the volume of CRA-related and non-CRA-related lending.

They then explain the further complications in the data, arising from the fact that CRA lending also refers to the distribution of loans across the range of borrowers, as well as to any loan made *within* the banking institution’s CRA assessment area to a low- or moderate-income borrower regardless of the neighborhood income *or* in a low- or moderate-income neighborhood regardless of borrower income. Then, of course, information could only be collected about loans held in the bank’s portfolio or for those loans that were originated, later sold but still serviced by the originating bank. The fact that a major report encountered such difficulties in compiling necessary information and had to look beyond the HMDA data to other sources such as the Reports on Condition and Income (Bank Call reports for commercial banks and some savings institutions) and the Thrift Financial Reports (for the

remaining savings associations) indicates the inadequacy of data collection, which may well be significant in terms of the relationship between CRA-lending and subprime loans.

It is estimated that the 500 banks and savings associations originated over \$570bn in home purchase and refinance loans in 1999 alone, of which about 10% was CRA-related. The level of profitability depends on whether it is calculated according to the institution or on a per CRA-related dollar basis. The authors point out that it is important to note that the large banks with assets of \$30bn or more were far more likely to assess their CRA-related house purchase and refinance lending as being less profitable than other lending in this product category than medium-sized banks (\$5bn to \$30bn). Overall the majority of banks held that such lending was profitable or marginally profitable. When reported on a per CRA-related dollar basis, 63% said that loans originated in 1999 were less profitable than other home finance or refinance lending, as compared with 44% on a per institution basis.

When it comes to performance, that is, delinquency and default rates, the authors argue that this is more difficult to estimate, as it is not clear what percentage of loans for each type of institution have been sold on. Where banks were in a position to report, about half of the survey respondents had higher rates for delinquency for CRA-related loans for home purchase than for overall lending; one-third reported that there was no difference; and one-sixth reported higher delinquency rates. The same analysis conducted on a per CRA-dollar basis gave higher credit losses for CRA-related loans than for other loans (46% as compared with 28%). The originating costs of CRA-related loans for home purchase are about the same, but in some cases the servicing costs may be higher. In general, most banks, especially the large ones, reported that pricing is similar for both types of loans or in many cases lower than for CRA-related home purchase and refinance loans. When it comes to calculations on a per-CRA dollar basis, many more report that the originating and servicing costs are higher. In other words, the report concluded that most of the banks surveyed at best did not regard CRA-related lending as particularly profitable.

If it was not particularly profitable, then why did banks engage in it at all? The authors of the report note, in their short article in the *Economic Commentary*, 2000, that only 1% of the respondents stated they did it in order to obtain a “satisfactory” or “outstanding” response, which is hardly surprising: “A large share said they established their programme to meet the local community’s credit needs and to promote its growth and stability.”³⁴ Whilst that was no doubt true, in the political context of the time, and given that merger and acquisition proposals could be delayed if they did not reach the CRA goals, it must be seen as just one of the reasons for the banks to engage in CRA-related loans.

The CRA and the subprime crisis

Since the beginning of the financial crisis, a fierce debate has raged. The issue: did the Community Reinvestment Act and its amendments *cause* the crisis? Proponents of the Act both within Congress and amongst many analysts deny that it had such an impact; others argue that the Act did not increase lending to low- and moderate-income families, or to minorities at all, so that it would not have had any impact on the financial crisis, nor did it increase subprime lending; this view is expressed by Christopher Perry and Sarah Lee on the basis of their regression discontinuity design.³⁵ Using HMDA loan application data, plus bank data from the FDIC Summary of Deposits database and FRB's commercial bank database, and on the basis of their analysis, they find little evidence that the CRA caused a reduction in loan rejection rates for low-to-moderate neighborhoods or individuals between 1993 and 2003. Rejection rates are lower for banks operating in their CRA assessment areas, and this difference holds both for loans to low- and moderate-income borrowers and for loans to high-income borrowers. This study, however, makes no reference to underwriting standards and the encouragement provided by the CRA to introduce "flexible" lending standards.

Others argue that the CRA did fulfil the aims and objectives which President Clinton desired and of which he was so proud. Those who take this view (some of whom still want the Act to be strengthened) accept that while it did bring about an increase in subprime lending, it was such a small percentage of CRA lending that it could not have and therefore did not cause such effects.

Whether or not the CRA contributed to the increase in low- to moderate-income lending, there was undoubtedly a vast increase between 1993 and 2000, according to a number of studies, especially ones conducted by those supporting the CRA. For example, a study by Harvard's Joint Center for Housing Studies found that home purchase loans to such borrowers and neighborhoods rose by 77% during that period, more than the overall increase in lending for house buying, which was 53%.³⁶

Others argued that the growth rates were even more impressive, if broken down into different ethnic groups. Michael Barr calculated that between 1993 and 1999, the number of home purchase loans to Hispanics increased by 121%; to Native Americans, by 118%; to African Americans, by 91.0%; to Asians, by 70.1%; and to whites, by 33.5%. Over that period, the number of home purchase loans extended to applicants with incomes less than 80% of the median increased by 86.2%, a much higher rate of growth than for any other income group.³⁷

These calculations were based on HMDA data as reported by the Federal Financial Institutions Council, but, as Barr acknowledges, this may overstate the growth in lending to Hispanics, since their household growth was much

higher than white households at the time (36.7% as compared with 6.2%.) Adjusting for differential levels of household formation, the growth for whites was 3.58 times its household growth of 6.2%; for Hispanics, 3.31 times; for blacks 7.34 times its household growth of 12.4%; the figures still show progress for minorities. Various other measures are used, all indicating growth in lending to low- and moderate-income areas: for example, in 1990, there were 19.6 million home owners in such areas, 49.65% of the number of home owners in high-income areas. By 2000, the ratio had improved, so that the number of home owners in low- to moderate-income communities was 55% of the number in high-income areas. The number of the former group grew by 26.6% over the decade, while the number in high-income areas grew by only 14% with a net gain for minority home ownership. These figures are based on Michael Barr's calculations using US Census data from 1990 and 2000, and the evidence is supported by a number of other studies, indicating that the CRA improved access to home mortgage credit for low-income borrowers especially after the regulations were amended in 1995. The share of loans to individuals targeted by CRA and fair lending regulations originated by banks, thrifts, and their affiliates increased during the 1990s; other researchers found evidence consistent "with the view that the CRA has been effective in encouraging bank organizations, especially those involved in consolidation, to serve lower income and minority borrowers and neighborhoods."³⁸

By themselves, these growth rates do not show that this was due to the influence of the CRA alone. The method Michael Barr uses is to compare the growth in CRA lending by each CRA-regulated bank or thrift with the growth in its non-CRA lending. What emerges is interesting, and perhaps the most relevant argument: the number of CRA-related loans increased by 39% between 1993 and 1998, while other mortgage loans increased by only 17%. Even excluding affiliates, which are there by the lenders' discretion, they increased their lending to the target groups by 10%, whilst the lending to affluent areas did not increase at all. Over this period, the portfolio share of CRA-covered lender and affiliate mortgage loans going to these low- and moderate-income borrowers and to the relevant areas increased by 3%. There are indications that the growth in CRA lending to these groups continued to increase during the early part of the following decade.

The CRA and community groups

The argument that the impact of CRA-related loans did not spill over from the 1990s into the following decade has to take into account the fact that community groups not only continued to be relevant for low- to moderate-income areas, but pressed for it to be strengthened. Here the annual reports of the National Community Reinvestment Coalition (NCRC), an association of

over 600 community-based organizations that promote access to basic banking services, including credit and savings, create and sustain affordable housing, promote job development and ensure vibrant communities for America's working families are relevant. It includes a wide variety of organizations in its membership, ranging from community reinvestment bodies to local and state government agencies, amongst others. In its contribution to a forum on the future of the CRA, John Taylor and Josh Silver, NCRC President and Vice President respectively, point out in *The Community Reinvestment Act: 30 Years of Wealth Building and What We Must Do to Finish the Job* that "the CRA's effectiveness can also be measured by comparing the lending patterns of CRA-covered banks with those of lending institutions not covered by CRA exams. NCRC found that in 2006, depository institutions extended 23.5% of home purchase loans to LMI (low- to moderate-income borrowers), whereas non-CRA covered lenders extended 21.5%."³⁹ Their comments on the approach to CRA enforcement are also illuminating, and are as follows:

- (i) "Though the CRA regulation stipulates that the assessment areas include geographical regions containing bank branches, the regulation also states that the assessment areas include other regions in which the bank has originated or purchased a substantial portion of its loans.⁴⁰ Despite this regulatory clause, the federal agencies usually adopt a narrow definition of assessment areas for banks or thrifts that issue most of their loans through non-branch channels. For these banks, it is not unusual to encounter CRA exams that cover only the geographical area of the bank's headquarters."
- (ii) In a later paragraph, the authors point out that, "under the CRA banks have the option of including their non-depository affiliates, such as mortgage companies, on CRA exams. Banks are tempted to include affiliates on CRA exams if the affiliates perform admirably, but they will opt against inclusion if the affiliates are engaged in risky lending or discriminatory policies. This is counter to the essential purpose of the CRA, which is to ensure that the institution as a whole is meeting credit needs in a responsible manner."⁴¹

The NCRC welcomed the CRA Modernization Act, 2007 as a way of ending "this serious gap" in enforcing the CRA, as banks would be obliged to include all their affiliates in CRA exams. The submission argues strongly for this and other improvements in the CRA legislation, including its extension to nonbank financial institutions, including credit unions, securities companies, mortgage companies, insurance firms and investment banks. It is interesting that, in spite of this recognition of the changing structure of the financial services industry, they still make the point that "credit unions and independent mortgage companies do not offer as high a percentage of home loans to LMI

borrowers as banks.”⁴² In addition, safety and soundness examination should be integrated with fair lending reviews and CRA examinations. For these organisations and other witnesses, such as Michael Barr, the Community Reinvestment Act still had an important role to play in ensuring that low-to moderate-income borrowers have access to credit.⁴³

Of course, it can be argued that these are interested parties to a greater or lesser extent, but their views are supported by other analyses to which reference has been made, such as the view that of the banks responding to the Federal Reserve’s survey, most found that low- to moderate-income lending was at least marginally profitable, if not profitable. Another analysis examines the effects of CRA on lending patterns from different point of view, namely empirically, modeling changes in aggregate lending as a function of local economic characteristics and changes in those characteristics, based on changes in mortgage lending activity over three-year intervals and CRA lending agreements. The results of the analysis are “consistent with the view that institutions increase targeted conventional mortgage lending upon the introduction of the CRA agreement ... that it is new lending ... and is relatively short-lived. The results are broadly consistent with the notion that lenders view CRA agreements as a form of insurance against potentially large and uncertain costs of fair lending violations, poor CRA performance ratings, and adverse publicity from CRA-related protests of mergers and other applications.”⁴⁴

This analysis ties in with the behavior one would expect a bank’s executives to recommend to the board. The decision may even have been taken in such a context for such lending not to be a short-term activity, when it was open to public view. Analysts have taken note of the regulatory and broad political pressures to increase low- and moderate-income lending, especially for mortgages; it should be noted that CEOs and their boards would undoubtedly take account of pressures exerted by Congressional members as well as the wide range of community organizations, who would ensure that their criticisms of bank lending policies in low- to moderate-income areas were fully covered by the local media.

As critics alleged that the CRA was the cause of the recent mortgage crisis, a useful summary of the view taken by the Federal Reserve and other regulators is found in a speech given by Governor Randall Kroszner, a member of the Board of Governors of the Federal Reserve System.⁴⁵ Once again, this both insists that the CRA was effective *and* that it was not a cause of the subprime crisis. The governor refers first of all to the study of 2000, to which reference has already been made, to the effect that during the 1990s the CRA-prompted lending to lower-income individuals and communities was “nearly as profitable and performed similarly to other types of lending done by CRA-covered institutions.” Thus, with the backing of the Federal Reserve’s research, the CRA “has encouraged banks” to pursue “lending opportunities in all segments of their local communities,” which by implication they would not

have done without the CRA. If that was not the case, then the CRA would have been completely useless, whereas in fact regulators, politicians and community organizations alike argued that it was effective, with many strongly opposing its abolition. Thus the CRA may well have contributed to the growth in subprime lending in the period 2001 to 2006, although the governor insists that only “6% of the higher-priced loans were extended by CRA-covered lenders to lower-income borrowers or neighborhoods in their CRA assessment areas, the local geographies that are the primary focus for CRA evaluation purposes ... (banks) can also purchase loans from lenders not covered by the CRA, and in this way encourage more of this type of lending ... Specifically, less than 2% of the higher-priced and CRA-credit eligible mortgages sold by independent mortgage companies were purchased by CRA-covered institutions.”⁴⁶ It should be noted that subprime lending is here identified with ‘higher-priced’ lending, an inadequate definition, as will be shown in the next chapter.

Since Governor Kroszner refers to the lines of business not “previously tapped by forming partnerships with community organizations and other stakeholders to identify and help meet the credit needs of underserved areas,” it is worth exploring what such partnerships could entail. The 2007 Annual Report of the National Community Reinvestment Coalition provides an excellent account of the number and dollar value of such partnerships, based on a careful analysis of all the data provided by its member organizations.

The report covers the period from 1977 to the first part of 2007. Negotiations with lenders by community organizations have led to the former committing \$4.56 trillion in reinvestment dollars, of which \$4.5 trillion was committed between 1992 and 2007, whereas only \$8.8 billion was negotiated between 1977 and 1991. Apart from the increasing sophistication of the much larger numbers of community organizations, the NCRC argues that as banks became regional and national in scope, they recognized the importance of maintaining their local community lending and investing capacity. Not all of the lending went into meeting housing needs, and not all of the monies “committed” may have been actually lent, as some of the agreements cover several years.

The preface to the report notes that banks increasingly entered into unilateral agreements, presumably, and if for no other reason, to avoid public criticism; but it also describes the fluctuation in dollar amounts, which it relates to mergers and acquisitions. Examples are 1998, a year of mega-mergers, including the merger of the Bank of America with Nations Bank as well as Citigroup’s merger with Travelers, leading to the Bank of America pledging \$350 bn over ten years and to Citigroup pledging \$115 bn over ten years as a result. Fewer mega-mergers and less reinvestment were the characteristics of the following years, until 2003 and 2004, when the pledges increased dramatically with the watershed mergers of the Bank of America’s acquisition of Fleet, J.P. Morgan Chase acquiring Bank One, and Citizens taking over Charter One. The dollar amounts comprising the 2007 total achieved since 1977 consists of (a) agreements negotiated between community organizations/state and local governments with lenders during the

merger application process, and (b) voluntary CRA programs or commitments unilaterally announced by a lender. The largest community development was announced in 2008 at a Federal Reserve Bank Hearing on the proposed merger between the Bank of America and Countrywide Financial Corporation. It was for \$1.5 trillion, and the Bank of America would embark on the program once the merger was completed.⁴⁷

The point here is to look at the basis of lending agreements to lower- and moderate-income borrowers for single family units, since the vast amounts listed above were not all directed to housing. The examples selected show that the agreements were spread over the years between 1992 and 2006, and indicates the wide range of arrangements the banks agreed to make:

- (i) In its 2006 agreement with the Greenling Institute and California Reinvestment Coalition, Wachovia Bank pledged \$10.3bn for both single-family and multi-family loans with higher debt to equity ratios than usual, flexible credit history requirements, low down-payment requirements (\$15m commitment to down-payment assistance) and no closing costs. This followed agreements during its planned merger with SouthTrust in 2004 to include a lending goal of \$15bn in mortgages to low- to moderate-income borrowers and neighborhoods in seven different states, including Alabama, Florida, Georgia, Mississippi, North and South Carolina, Tennessee, Texas and Virginia. These were designed for lenders with impaired credit with no requirement for private mortgage insurance, up to 100% financing and low or no down-payment requirements.
- (ii) Others offered refinancing loans at lower rates: for example, in the 1999 agreement with New Jersey Citizen Action and the Affordable Housing Network of New Jersey, the Bank of New York pledged \$10m under a pilot project to offer refinance loans to borrowers with subprime mortgages. Borrowers were not required to have a minimum credit score provided they could demonstrate 18 months of satisfactory mortgage payments.
- (iii) As part of its 2003 pledge, CitiMortgage offered a closing cost assistance program for buyers in certain areas. The bank also agreed to allow borrowers with past credit difficulties to obtain a mortgage rate 2% lower than was usual for such borrowers to pay.
- (iv) The 1999 agreement between Sovereign Bank, New Jersey Citizen Action and the Affordable Housing Network of New Jersey committed the bank to offer a mortgage product with no private mortgage insurance, housing and debt ratios of 33/40, 1–1.5% below the market interest rate, 95% loan to value and up to 3% of the down-payment in the form of a gift or second mortgage. Over a period of three years, the bank will offer \$41m per year of such mortgages.

- (v) In their 1998 agreement, New Jersey Citizen Action and the Philadelphia Association of CDCs committed First Union to providing affordable home loans with no private mortgage insurance, down payments from “sweat equity” (i.e. recognition of work done to improve the property), debt to income ratios as high as 33 and 38%, and loans as low as \$10,000. Similarly, the Maryland Center for Community Development and First Union agreed that the bank would provide a 100% loan-to-value product with no down-payment or mortgage insurance and \$500 of the borrower’s own funds at closing, which can be a gift or paid by the seller.
- (vi) In its \$1.25bn agreement with the Ohio Community Reinvestment Project (OCRP) and the Coalition of Homelessness and Housing in Ohio (COHHIO) signed in 1998, Fifth Third bank agreed to maintain a “Home Sweet Home” mortgage with no private mortgage insurance and 3% down payments.
- (vii) In 1998, Household International signed a \$3bn agreement with Inner City Press/Community on the Move and the Delaware Community Reinvestment Action Council. Household specializes in offering subprime, high-interest loans to those with blemished credit histories. As part of the agreement, Household committed itself to set up a lower-interest home equity product for those borrowers with “A” or “A-minus” credit histories. This was welcomed as a precedent-setting agreement for minorities, whom, it was claimed, were regarded as subprime borrowers in numbers disproportionate to their population.
- (viii) In its \$200m CRA agreement with the City of Cleveland, Firstmerit would offer a “First Choice Mortgage” with a 97% loan-to-value ratio, 33/44% housing and debt ratios, no private mortgage insurance and no application or origination fee, starting in the year 2000.

Fewer specific examples are given of other aspects of flexible lending standards, except that the report refers to many CRA agreements which adopt a more flexible approach to credit histories, given that many low-income and minority applicants lack traditional credit histories or have a record of late payments. With regard to employment history, most lenders require borrowers to have between two and five years at the same job to qualify for a loan. This often excludes low-income and minority applicants, who change jobs frequently but may maintain a steady source of income. Many CRA agreements have included provisions to address this problem.

The damage which was done by pushing banks to make such commitments can be seen from the following: Wachovia Bank collapsed in September 2008 and was taken over by Citibank, with losses of \$42bn; Sovereign Bank

went through a series of mergers and acquisitions until it was taken over by Santander in 2009; First Union was taken over by Wachovia in 2001; Household International was purchased by HSBC in 2003, but in September 2007, HSBC took a write-down of \$800m and closed it down.

The report is valuable, in that it gives further insight into what “flexible underwriting standards” were taken to mean. The true impact of the Community Reinvestment Act and hence of its contribution is difficult to assess for a variety of reasons: the inadequacy of the HMDA statistics; the apparent “safety and soundness” of subprime lending during the 1990s and the years immediately following; the extent to which banks and thrifts purchased subprime loans from non-CRA-lenders; and the lack of data linking loan origination with loan performance. Those who argue that the CRA did not cause the crisis point to the lack of an agreed definition of “subprime” loans; instead many euphemisms were used, such as the references to “flexible” underwriting standards. But these standards involved high LTV ratios, high debt-to-income ratios, low credit scores or no credit history at all; in short, the key characteristics of a subprime loan. The Boston Handbook spelt out what the standards were from the start. It was a clear signal to the banks. The CRA provided strong incentives, and even pushed banks into lowering their lending standards. It may not have been *the* cause of the crisis, but it undoubtedly played a part. The inadequacy of the data and the longest period of economic expansion between 1992 and 2000 served to hide the effects of the growth of subprime lending, which began then. The CRA was an important cause of the subprime crisis, but by no means the only one.