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**The Community Re-investment Act of 1977:  
Its Legislative History and Its Impact on Applications for  
Changes in Structure Made by Depository Institutions to the  
Four Federal Financial Supervisory Agencies**

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**THE COMMUNITY RE-INVESTMENT ACT OF 1977:**

**Its Legislative History And Its Impact On Applications For Changes In Structure Made By Depository Institutions To The Four Federal Financial Supervisory Agencies**

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## THE COMMUNITY RE-INVESTMENT ACT OF 1977:

### Its Legislative History And Its Impact On Applications For Changes In Structure Made By Depository Institutions To The Four Federal Financial Supervisory Agencies

#### I. INTRODUCTION

When he introduced S.406 in the Senate, Senator Proxmire, Chairman of the Senate Committee on Banking, Housing and Urban Affairs commented that the bill was based on four "widely shared assumptions" including the assumption that

.....a public charter conveys numerous economic benefits and in return it is legitimate for public policy and regulatory practice to require some public purpose . . .<sup>1</sup>

Later, in the course of *opening the* hearings on S.406, the Chairman compared a bank charter to "a franchise to serve local convenience and needs"<sup>2</sup> and suggested that "it is fair for the public to ask something in return."<sup>3</sup>

This premise, that financial institutions have, responsibilities to the public which exceed the obligation to maintain their own solvency and profitability, may represent the latest evidence of a gradually evolving change in the way that Congress views the banking system. and the proper role of the government in overseeing it.

Traditionally, this country has been served by a decentralized "entrepreneurial" banking system, in which those who were able to demonstrate competent management and adequate capitalization were permitted to undertake or initiate a banking enterprise, subject to such limitations on entry and expansion as were necessary to prevent "undue" competition and to assure "safe and sound" practices - all with the ultimate goal of providing for the financial success of chartered institutions.<sup>4</sup> The obvious "public purposes" to be served through government regulation in such a system included the protection of the funds of depositors-and the investments of shareholders, *per se*. In addition, the public is served through the maintenance of a nationwide network of private financial intermediaries available to carry out the many money-related functions necessary to the operation of the economy (e.g. control of money supply, banking and trust services).

Virtually all of the federal post-depression laws which together define our modern banking and savings association industries have been designed from this perspective, so that in a 1978 report of the Senate Committee on Governmental Affairs it was stated that "the principal justification for bank examination has been and, in a real sense, continues to be the early detection and *subsequent prevention* of unsound and unsafe banking practices" and "the Congress has determined that both stability of the nation's banks and competition

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<sup>1</sup> Congressional Record, daily ed., January 24, 1977 at S.1202. The Community Re-investment Act provides that "regulated financial institutions have a continuing and affirmative obligation to help meet the credit needs of the local communities in which they are chartered" and directs the federal financial supervisory agencies to "assess" an institution's record of meeting these needs in the examination process, and "take such records into account" in evaluating applications for charter, insurance, branching, relocation, merger or acquisition of shares requiring approval under the Bank Holding Company Act of 1956.

<sup>2</sup> Hearings before the Committee on Banking, Housing and Urban Affairs, United States Senate, 95th Congress, First Session on S.406, March 23, .24 and 25, 1977, at 2. (Hereafter Hearings).

<sup>3</sup> Hearings at 2.

<sup>4</sup> See Loring C. Farwell, Frank Herbert Gane, Donald P. Jacobs, Sidney L. Jones and Roland I. Robinson, Financial Institutions, 4th Ed. Richard D. Irwin, Inc., Homewood, Illinois (1966), Fifth printing (1970), Chapters 3 and 4 and Hackley, "Our Banking System," Virginia Law Review, Vol. 52, May, 1966.

among them are the pre-eminent goals of bank regulation.<sup>5</sup> From this point of view, maintenance of the viability and profitability of a depository institution is in and of itself the goal of regulation, so that if this goal is fulfilled, the "public purpose" obligations of *financial institutions* are, a fortiori, satisfied.

Within the past decade, however, Congress has taken an increasingly broader view of the role to be played by financial institutions in the economy, and has enacted numerous consumer protection and civil rights measures which place affirmative responsibilities on depository institutions beyond the mere obligation to operate safely and soundly<sup>6</sup>, and which give the financial regulatory agencies responsibility as "enforcers" in the compliance scheme.

The preamble to the Home Mortgage Disclosure Act, provides that:

- (a) The Congress finds that some depository institutions have sometimes contributed to the decline of certain geographic areas by their failure pursuant to their chartering responsibilities to provide adequate home financing to qualified applicants on reasonable terms and conditions. (Section 302(a), Title III, Pub. Law 94-200)

Paragraph (b) of the same section implies that depository institutions have an obligation to "serve the housing needs of the communities and neighborhoods in which they are located" and enforcement of the record keeping provisions of the Act is given to the various federal financial regulatory agencies.

Similarly, in the preamble to the Equal Credit Opportunity Act, Congress found that in the absence of discrimination by creditors "[E]conomic stabilization would be enhanced and competition among the various financial institutions would be strengthened . . ."<sup>7</sup>

This act (ECOA) placed far-reaching obligations on lenders and their regulators and, perhaps to a greater degree than any preceding statute had a direct impact on the substantive underwriting decisions, which lenders make.

It is from this new and evolving congressional perspective on the proper role of financial institutions and the proper role of the agencies, which regulate them that the Community Re-investment Act emerged. It passed despite the earnest warnings of its opponents that it represented a major move in the direction of "credit allocation" and that it constituted an unreasonable addition to the administrative burden being placed on an industry already submerged in federally mandated paperwork. However, more remarkable than its passage is the deference shown by the supporters of the Act to the concerns which were voiced by its opponents, and the Community Re-investment Act must be interpreted against the background of a Congressional ambivalence toward the proper role of the federal government in supervising private financial institutions.<sup>8</sup>

As a consequence of this ambivalence, the legislative history of the Community Re-investment Act contains several instances in which the principal proponents of the bill have taken the initiative in pointing out its limitations and its weaknesses.

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<sup>5</sup> Study on Federal Regulation, Vol. 5, Chapter 6, Committee on Governmental Affairs, United States Senate, December 28, 1977 at 212 and 207 respectively.

<sup>6</sup> See The Fair Housing Act of 1968 (42 U.S.C. §3601 et seq.), Truth In Lending (15 U.S.C. §1601 et seq.); Real Estate Settlement Procedures Act (12 U.S.C. §2601 et seq.); Fair Credit Billing Act (15 U.S.C. §1666); Equal Credit Opportunity Act (15 U.S.C. §1691); Home Mortgage Disclosure Act (12 U.S.C. §2801 et seq.).

<sup>7</sup> Pub. Law 93-495, Section 502.

<sup>8</sup> This is an ambivalence characteristic, perhaps, of a legislature in a mixed free-enterprise economy, which, while realizing the extent to which government has and will continue to intervene in the affairs of business, is never wholly comfortable with this result.

The Community Re-investment Act must also be viewed in the context of the continuing controversy over so called "redlining" by conventional mortgage lenders in older, urban or racially integrated neighborhoods.

The legislative history of the act reveals that both its sponsors and its critics viewed it as a measure aimed at helping the "inner cities" and at urban revitalization, although neither phrase is used in the text of the law. Knowledge of this factor contributes substantially to an understanding of Congressional intent behind the phrases which were used. It is also helpful to understand the way that those who drafted and supported the bill perceived-of the "redlining" phenomena. They saw it, essentially, as the "exporting" of funds deposited by residents in neighborhood institutions to uses outside of the neighborhood - uses which neither benefit the depositors directly (through mortgage and rehabilitation loans) nor indirectly,(through development-related loans to neighborhood enterprises).<sup>9</sup>

As a final background consideration it should be noted that the Community Re-investment Act was deliberately structured upon pre-existing statutes, regulations and procedures dealing with applications for change in bank structure, and that in applying the new statutory standards the regulatory agencies are constrained not to ignore the judicial and administrative literature which has built up on this issue over the years. Because of its unique format, the Community Re-investment Act must be read together with existing criteria and because it was "superimposed" upon the existing regulatory structure, the Community Re-investment Act will be subject to the limitations and imperfections of that structure.

## II. THE ACT

From its initial introduction as Senate Bill S.406, in January of 1977 to its final enactment in October of the same year, the Community Reinvestment Act ("CRA") existed in three different versions. The first, as introduced by Senator Proxmire is set forth in Appendix A.<sup>10</sup> The second, as amended in mark-up and reported out of the Senate Banking Committee as Title V of the Housing and Community Development Act of 1977 (S.1523) is set forth in Appendix B.<sup>11</sup> This version was subsequently adopted by the Senate on June 7, 1977 as Title IV of S.1523.<sup>12</sup> The final version, as further amended and reported out by a Committee of Conference on the 1977 Housing and Community Development Act, as Title VIII of that Act, is set forth in Appendix C.<sup>13</sup> This conference report for the joint bill numbered H.R. 6055 was introduced in the House on September 26, 1977<sup>14</sup> and the Senate on October 1, 1977.<sup>15</sup> The Bill passed the Senate in final form on October 1st and the House on October 4th. It was signed into law by President Carter on October 12, 1977.<sup>16</sup> The only occasion on which the House of Representatives considered the Community Reinvestment Title was in the course of final enactment in October of 1977, and debate was minimal. There were no hearings held on Community Re-investment in the House, and there was no comparable bill contained in the House version of the 1977 Housing and Community Development Act.

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<sup>9</sup> It has been argued that this view of redlining is naive, or at least incomplete, and that by designing a bill to address only this aspect of the investment/disinvestment process, Congress has missed an opportunity to deal with the problem in a comprehensive way, and, in some respects, has enacted a statute which will be counterproductive in the long run because it ignores the more important systemic aspects of the so-called "redlining" phenomenon. See testimony submitted by the Federal Home Loan Bank Board. Hearings at 238.

<sup>10</sup> Congressional Record, daily ed., January 24, 1977 at S.1202.

<sup>11</sup> See Report of the Committee on Banking, Housing and Urban Affairs, United States Senate, to accompany S.1523, together with additional views, 95th Congress, 1st Session, Report No. 95-175, May 16, 1977 pp. 33, 59, 81.

<sup>12</sup> S.15-13 passed by a vote of 79 to 7.

<sup>13</sup> Conference Report, to Accompany HR. 6655, The Housing and Community Development Act of 1977, House of Representatives, 95th Congress, 1st Session, Report No. 95-634, September 26, 1977.

<sup>14</sup> Congressional Record, daily ed., September 26, 1977, H.10124 and S.

<sup>15</sup> Congressional Record, daily ed., October 1, 1977, S.16112.

<sup>16</sup> Public Law 95-128.

There were hearings held on the bill in the Senate.<sup>17</sup> These hearings were on the original version of the Act, prior to adoption of the two sets of amendments.<sup>18</sup>

The Community Re-investment Act is a short statute, divided into six sections. The first, second and sixth sections have remained essentially unchanged throughout the several modifications of the bill. (The time limit of "390 days" for the issuance of regulations, contained in Section 6 of the bill (now section 806) was "180 days" prior to the amendments made in conference).

Section 3 (now section 803) has remained unchanged except for (a) the deletion of paragraph five (definition of consumer deposit) which occurred during the mark-up in connection with deletion of the several procedural requirements of section 4, and (b) deletion of paragraph four (definition of primary savings service areas) which was deleted in the Conference Committee in connection with elimination of that entire "thrust" from the bill.

Section 4 (now Section 804) has undergone the most substantial change and was rewritten entirely in the mark-up to provide the regulatory agencies with less specific direction and more flexibility in implementing the Act. It was changed again in the Committee of Conference, when the concept of "primary savings service area" was changed to the concept of entire community."

The successive changes in the Act, naturally, represent a series of compromises needed to gather the support necessary for passage. This is particularly so with respect to the changes made to the procedural aspects of the bill. However, the shift from the "primary savings service area" concept to the "entire community" concept also represents an attempt to improve the proposal in response to generally uniform criticism of the "primary savings service area," by regulators, lenders, and others who testified in connection with S.406.

### **III. CONGRESSIONAL INTENT**

#### **A. Ambiguities**

Section 802 of the Act contains a number of Congressional "findings"

Section 802.(a) The Congress finds that (1) regulated financial institutions are required by law to demonstrate that their deposit facilities serve the convenience and needs of the communities in which they are chartered to do business. (2)the convenience and needs of communities include the need for credit services as well as deposit services; and (3) regulated financial institutions have continuing and

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<sup>17</sup> Hearings, cited in footnote 2, page 1, above.

<sup>18</sup> A chronological list of important events in the legislative history of the CRA is set forth below:

January 24, 1977 - S.406 introduced in Senate by Senator Proxmire.

March 23-25, 1977 - Hearings in the Senate on S.406.

May 9-10, 1977 - Mark-up of S.406 in Senate Banking Committee. Amendments to Bill adopted. Motion to delete S.406 from S.1523 defeated.

May 16, 1977 - S.406 incorporated as Title V of S.1523 and reported favorably out of Senate Banking Committee.

June 6, 1977 - Senate rejects Amendment No. 314 offered by Senator Morgan to delete Community Re-investment Title from 1977 Housing and Community Development legislation.

June 7, 1977 - Senate adopts S.1523 including Community Re-investment Title.

September 26, 1977 - Committee of Conference Reports H.R. 6655, containing an amended version of Community Re-investment Act.

October 1, 1977 - Passes Senate.

October 4, 1977 - Passes House.

October 12, 1977 - Signed into law - Agencies given 390 days to issue implementing regulations.

affirmative obligations to help meet the credit needs of the local communities in which they are chartered. (b) It is the purpose of this title to require each appropriate Federal financial supervisory agency to use its authority when examining financial institutions, to encourage such institutions to help meet the credit needs of the local communities in which they are chartered consistent with the safe and sound operation of such institutions.

There are three serious ambiguities created by the above statement of Congressional findings and purpose. First, the Congress "found" the prior existence of a certain state of affairs in connection with the obligations of institutions and regulators and then, in the same enactment, directed that the agencies concerned undertake to bring about this very same state-of affairs. This seeming paradox calls into question the underlying need for the legislation. Second, the preamble referring to the obligations of institutions speaks in terms of the "needs of the communities in which they are chartered to do business" and to the "credit needs of the local communities in which they are chartered." The "statement of purpose" also includes the latter phrase. These references were originally made, in a bill which required a financial institution to demonstrate how it was meeting the credit needs of the "primary savings service areas" in which it or its subsidiaries have already been chartered to do business (Appendix A, Section 4(1) (D)) and, "primary savings service area" was defined as a compact area contiguous to a deposit facility (Appendix A, Section 3, (4)). Thus, in the original version of the bill, the phrase "local community" was modified by the phrase "primary savings service area" and, wisely or unwisely, the geographic focus of the bill was made relatively clear. In the final version of the CRA, the references to "local community" are retained in the findings and statement of purpose but "primary savings service area" was deleted and replaced by the requirement that the regulatory agencies

assess the institution's record of meeting the credit needs of its entire community including low and moderate income neighborhoods . . . . (emphasis added)

The juxtaposition of the phrases "entire community" and "local communities in which they are chartered" raises questions about the proper litmus test to be devised by the agencies for determining the geographic parameters of the area to be served under the CRA.

The third ambiguity centers around the words "credit needs" which appear not only in Section 802, but also in Section 804, the "operative section" of the Act. Congress has provided little guidance to the regulatory agencies in setting forth which credit "needs" of communities are to be given priority, in circumstances where various types of financial institutions offer various kinds of credit services, frequently specializing in particular kinds of loans to the exclusion of others. The CRA is also silent on the issue of how "needs" within a particular community-are to be ascertained or measured or, once determined, how the record of meeting needs is to be "taken into account" in the evaluation of applications for entry or expansion (Appendix C, Section 804(2).)

To resolve these ambiguities, it is necessary to analyze the legislative history of the CRA.<sup>19</sup>

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<sup>19</sup> Several legislators were also concerned about the vagueness of the Act and it appears that a commitment was given in conference that a House subcommittee would hold hearings on the CRA prior to the promulgation of regulations, in order to assist the regulators in their task. Although not contained in the statement of the managers, this commitment was apparently made by Mr. Reuss and was regarded as a condition of including the Senate-approved CRA in the Conference Report. See statements of Congressmen Reuss, Brown and Ashley, Congressional Record, daily ed., October 4, 1977 at H.10568. While no Congressional hearings have been noticed as of January 20, 1977, the four federal regulatory agencies, in an unusual act of unanimity, have announced a nationwide series of hearings on the CRA to help regulators in the rule making process. See Notice of Joint Hearings, FRB Docket No. R-0139, January 19, 1978.

## B. The "Gestalt" Of The Act

There is evidence in the record that when Congress speaks of "local credit needs" and the needs of the "primary savings service area" it is utilizing an interchangeable shorthand reference to the housing and community development needs of areas in which there has traditionally been a statistically low level of conventional financing of home sales or home rehabilitation areas which may be on the threshold of decline. If a pecking order of priority can be established for the types of loans which Congress probably intended to be given priority in assessing a lender's record under the Act, loans relating to the housing and community development needs of older urban and rural areas threatened with decline would probably rank highest.

Confusion arises, however, because instead of referring to such areas directly in the text of the Act, Congress placed the emphasis on loans in the "community" or "service area" in which an institution is located. The source of this confusion is probably the fact that Congress associated low levels of conventional lending with a threat to neighborhood viability and viewed the reason for low levels of investment in urban neighborhoods from a fairly monolithic or one-dimensional perspective; the exporting of "local" deposits to other areas.

For whatever reason, the lawmakers who were the principal proponents of the Community Re-investment Act have apparently crystallized one particular concept of "redlining" which underlies this legislation as well as other laws<sup>20</sup>, and the interchangeability of this concept with the goals of the CRA can be seen in the following examples. In the Report of the Senate Committee on Banking, Housing and Urban Affairs on the Housing and Community Development Act of 1977<sup>21</sup> (hereafter Committee Report) the "need for new legislation" (the CRA) is described as arising from the fact that the financial regulatory agencies lack systematic, affirmative programs "to encourage lenders to give priority to the credit needs of their home area."

The report then continues to the effect that:

As a consequence, the Committee is aware of amply documented cases of redlining, in which local lenders export savings despite sound local lending opportunities.

and

While the Committee rejected the course of setting percentage targets for reinvestment, it should be self-evident that an institution exporting 99 percent of its dollars outside the city in which it is chartered is not serving community convenience and needs. (Committee Report at 34)

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<sup>20</sup> The reason for this narrow view of the urban disinvestments process may be the re-enforcing affect of repetitious testimony by the same witnesses before the Senate Banking Committee on the issue of redlining. Comparison of the records of the following hearings, all within the past two years, reveals re-occurring themes. It should be noted that several of the witnesses regarded as spokesmen for community groups are from Illinois, a unit-banking state where much of the red lining controversy has centered. In Chicago, the concept of an area "contiguous to" an institution's deposit facilities is fairly important in controlling neighborhood re-investment. This is not so in metropolitan areas where the entire SMSA, or the entire state, is within an institution's "market area." See e.g. Hearings Before the Committee on Banking, Housing and Urban Affairs, United States Senate (a) on the Home Mortgage Disclosure Act of 1975, 94th Congress, First Session, on S.1281, May 5, 6, 7, 28, 1975; (b) on Home Mortgage Disclosure and Equal Credit opportunity, 94th Congress, Second Session, November 23, 1976, and (c) Neighborhood Preservation, 94th Congress, Second Session, June 14, 1976.

<sup>21</sup> Report 95-175, May 16, 1977 at 33.

In opposing an amendment offered on the floor of the Senate to delete the Community Re-investment title from S.1523, Mr. Proxmire provided additional evidence that the goals of the CRA and the Congressional view of redlining and neighborhood decline are intertwined:<sup>22</sup>

Mr. President, for more than 2 years the Banking Committee has been studying the problem of redlining and the disinvestments by banks and savings institutions in older urban communities.

By redlining let me make it clear what I am talking about. I am talking about the fact that banks and savings and loans will take their deposits from a community and instead of reinvesting them in that community, they will invest them elsewhere, and they will actually or figuratively draw a red line on a map around the areas of their city, sometimes in the inner city, sometimes in the older neighborhoods, sometimes ethnic and sometimes black, but often encompassing a great area of their neighborhood.

We also know that small town banks sometimes ship their funds to the major money markets in search of higher interest rates, to the detriment of local housing, to the detriment of small business, and farm credit needs.

In 1975 Congress took the first small step against redlining. We passed a mild version of the Home Mortgage Disclosure Act, requiring financial institutions just to disclose where home mortgage loans are made.

The data provided by that act remove any doubt that redlining indeed exists, that many credit-worthy areas are denied loans. This denial of credit, while it is certainly not the sole cause of our urban problems, undoubtedly aggravates urban decline.

I might point out, Mr. President, that the redlining information has not been available just for 2 months, not just for 3 months, not just for 4 months, but ever since last September 30 in most cases.

Furthermore, the use of that data has been quite extensive. The New York papers have had a very elaborate series of stories on the amount of disinvestments in New York pointing out that about 11 percent of the money deposited in Brooklyn remains and 89 percent is invested elsewhere.

In the District of Columbia we find about 90 percent of the money is invested outside of the community where the money is deposited. Chicago has an enormous amount of disinvestments; in California, the data and details flowing from our legislation show that Los Angeles has suffered a great deal of disinvestments; St. Louis has massive disinvestments; Indianapolis is the same way; and in Cleveland, the Cleveland Plain Dealer had a series of stories pointing out this very serious problem, and highlighting the fact that this is something that is undoubtedly contributing or has contributed for a long time to the decay of the city.

Therefore, the committee included title IV to reaffirm that banks and thrift institutions are indeed chartered to serve the convenience and needs of their communities, and as the bill makes clear, convenience and needs does not just mean drive-in teller windows and Christmas club accounts. It means loans. (emphasis added)

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<sup>22</sup> Congressional Record, daily ed., June 6, 1977, at S.8958

Reflecting the above view of the redlining/disinvestment issue-the early version of the Act relied on an equation tying the obligation to lend to the source of deposits and ignored the circumstance in which the area needing funds cannot generate sufficient deposits to sustain its own demand -the capital short area. Accordingly, where capital short areas would have coincided with the mature, urban area intended to be helped by the CRA, the early version of the Act would have hindered, not assisted, the revitalization process. The view of "redlining" implicit in the early version of the CRA also ignored the problem of institutions located in affluent areas which are in proximity to "disinvested" areas. By tying the responsibility to lend primarily to the source of deposits, the early version of the law would have sanctioned the decisions of suburban institutions not to make loans in adjoining urban areas. Further, this insular view of "redlining" did not adequately address the obligations of large city or state-wide institutions, or money center banks, which occupy a "community" so large that it might include as many, if not more, affluent areas than areas threatened with decline. For such institutions, the obligation to lend in an area "contiguous" to deposit facilities is meaningless, and the obligation to lend in the "local community" or its "primary savings service area" forges no guarantee at all that "disinvested" communities will be better served.

In addition, such institutions, as well as smaller institutions, make many types of loans necessary to the housing infrastructure, or to other aspects of a healthy operating economy, which, while they may not have a direct effect on housing revitalization, are nonetheless important.

Finally, the early version of the bill ignored the macroscopic view of the banking and savings industry, which includes a dynamic secondary market designed to export funds to capital short areas. It also appeared to ignore the practical aspects of asset management, pursuant to which lending institutions are presented with a fluid and continuing variety of investment options, which they can move in and out of, in an attempt to maximize yield. To the extent that the original act was designed, even inadvertently, to interfere with the operation of the secondary market, or foreclose the variety of investment options available to regulated institutions, it would have changed drastically the nature of the financial sector of the economy, and not necessarily helped the urban revitalization effort in so doing.

However, a review of the legislative history of the Act reveals that it was not the intention of Congress to bring about such a major dislocation in the banking system. The goals of the sponsors of the bill were considerably more modest, and they sought only to affect a change of attitude toward urban lending by lenders and regulators.

The changes made to the Act by amendment prior to final action, read together with the comments made by proponents and opponents of the act in the course of its being considered, indicate a Congressional intention to avoid the problems cited above while at the same time retaining the original purpose of the Act, to encourage private conventional lending activity in older, urban areas.

This is illustrated in the action of the Conference Committee in deleting all reference to "primary savings service area" and substituting "the entire community, including low and moderate income neighborhoods," in its stead. An explanation of the change appears in the Conference Report<sup>23</sup> and demonstrates the important connection seen by Congress between the CRA and the development of housing and community development programs in urban areas:

The Senate provisions were agreed to with two amendments. The first would substitute consideration of the credit needs of "the entire community, including its low and moderate income neighborhoods." for the credit needs of its "primary

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<sup>23</sup> House of Representatives, 95th Congress, 1st Session, Report No. 95-634, Conference Report to Accompany 1JR 6655, September 26, 1977 at 76.

service area." The second amendment would defer implementation of the title for 390 days instead of 180 days.

In adopting the Senate provision the conferees recognize the vital interconnection between successful community and housing development and local private investment activities. The effectiveness of the community development program, the housing assistance programs, and the mortgage insurance programs, as amended by this conference report depend in large part upon the availability of private capital, particularly as made available through local lending and financial institutions. This title and other amendments contained in this bill are designed to encourage more coordinated efforts between private investment and federal grants and insurance in order to increase the viability of our urban communities.

On the floor of the Senate, Mr. Proxmire, the sponsor and principal proponent of the bill was asked by Senator Morgan to explain the differences between the bill as originally acted on by the Senate in June, and as amended in Conference. Senator Proxmire's answer illustrates the extent to which the phrase "local communities" is really intended to mean something broader than the area contiguous to deposit facilities and operates as a sort of proxy for a-Congressional approach to redlining:

The Community Investment Act, as we agreed to it earlier in the Senate, was designed, as the Senator will recall, to provide as much incentive as we could for local investment in local communities. We found, in many cases, that banks had taken a great deal of money from local communities and invested it outside their communities and had not met the needs and requirements of the local communities.

We provided that when a bank wanted to open a branch the regulating agencies would have to take into account how much they invested locally, and they might have this as a decisive consideration under some circumstances.

What this legislation does, in contrast to what passed, is to delay implementation for 390 days, just about a month longer than a year, after enactment. It also redefines the primary service area to be served on a broader basis, so that there be no question that it is simply the immediate community where the bank was located.

Those are the two principal modifications. (emphasis added)<sup>24</sup>

Prior to coming to conference, the bill was changed in the Senate Banking Committee to eliminate some of the "red tape" and to change the narrow impact created by the original text of the bill. As explained by Senator Proxmire during the mark-up session, even community groups criticized the original version of the Act:

Thus, a Los Angeles savings and loan wishing to branch into Beverly Hills could pledge to reinvest in Beverly Hills all of the money it took out of Beverly Hills and\*this wouldn't help the redlined areas. (Mark-up Transcript, Vol. IV, Monday, May 9, 1977 at 283)

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<sup>24</sup> Congressional Record, daily ed., October 1, 1977, S.16114.

Recognition of the problems created by the original text led ultimately to the changes (Mark-up Transcript at 284.)

The changes made in the original version were very much in keeping with the original underlying purposes of the Act. At the hearings on the original version of S.406 one lender pointed out that by tying the lending obligation to the location of deposits, areas where deposits are dropping off would be hurt. Senator Proxmire responded by saying:

That is an excellent point. It would be ridiculous in my view for a regulating body to indicate that because the deposits dropped, therefore the investment of the bank in the community would drop. (Hearings at 294).

Mr. Proxmire indicated that the language might have to be changed, as, in fact, it was. (See also Hearings, at 346) (Purpose of bill is not to gauge lending on amount of deposits received from a given community.)

That the "gestalt" of the bill is the revitalization of urban areas through housing related lending is illustrated in various comments made by Senator Proxmire and others. In the House, Mr. Ashley observed that the provisions of the Community Re-investment Act, in its final version, "complement well the housing and community development elements" of the omnibus housing bill by "encouraging increased attention by financial institutions to the mortgage credit and other financing needs of their communities."<sup>25</sup> (emphasis added)

In opposing one of the earlier versions of the Act, Senator Morgan suggested that the Home Mortgage Disclosure Act, Equal Credit Opportunity Act and Neighborhood Preservation Act (creating the Neighborhood Commission), as well as the President's Urban and Regional Policy Group were all directed at the same goal as the CRA and that passage of the CRA would, therefore, be "overkill."<sup>26</sup> He also questioned whether Congress really knew if the "credit needs of the inner cities are being met," implying, in context, that the CRA was directed at revitalizing "inner cities." (emphasis added)

The Federal Home Loan Bank Board, in a letter to Senator Morgan commenting on S.406 opined that "it is the Board's understanding that a significant purpose of the bill is to serve housing credit needs - as opposed to other "credit needs" such as consumer loans."<sup>27</sup>

When opening the hearings on S.406, Senator Proxmire commented that an underlying premise of the bill is that private financial institutions must play the "leading role" in providing the capital required for "local housing and economic development needs."<sup>28</sup> (emphasis added) As an example of a lender meeting these needs, Senator Proxmire referred to a bank with a record of "revitalization of a so-called declining neighborhood through an aggressive, affirmative program of local housing and small business lending."<sup>29</sup> (emphasis added) Another example given of lenders meeting community needs were those lenders participating in the Philadelphia Mortgage Plan. Examples given of lenders not meeting "community needs" included a bank with a policy of making "no home mortgage loans" and a District of Columbia lender with most of its loans in the suburbs.

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<sup>25</sup> Congressional Record, daily ed., October 4, 1977 at H.10565

<sup>26</sup> Congressional Record, daily ed., June 6, 1977 at S.8954-8955.

<sup>27</sup> Letter to Honorable Robert Morgan, from Garth Maston, Acting Chairman, Federal Home Loan Bank Board, May 18, 1977.

<sup>28</sup> Hearings on S.406, at 1.

<sup>29</sup> Id., at 2.

In his statement accompanying introduction of S.406 in the Senate, the Chairman equated "community reinvestment" with "(R)ebuilding and revitalizing communities threatened by decline....."<sup>30</sup> and suggested that this would be "good for banking."

In his testimony in favor of the bill, Ralph Nader also perceived that it was intended to reverse the process which "reduces the supply of conventional mortgage loans and small business loans" in an area.<sup>31</sup>

Senator Tower, an opponent of the Act, expressed his view of it in the following statement:

*I don't quarrel with the ends of the proposal, and that is providing mortgage credit to creditworthy purchasers in the inner city areas (emphasis added)*<sup>32</sup>

Senator Heinz supported the bill, and viewed its purposes similarly, finding that it:

*. . . aims in a far too much neglected area, which is that of revitalizing, preserving and rehabilitating our existing neighborhoods . . .*

and

*. . . it is not uniquely a big city problem. It can strike just as hard in rural areas or in small or medium sized cities.*<sup>33</sup>

He also observed that the legislation would make lenders more sensitive "to the requirements of lending both to residential and small business entities in general in areas which are thought to be neglected at the present time."<sup>34</sup> (emphasis added)

Reviewing the limitations of the bill, and its inability to solve all of the problems of the cities, Chairman Proxmire commented at the hearings that "this is really a bill that has to go primarily to conventionally financed housing." (Hearings at 225)(emphasis added) Reinforcing this view of the bill as primarily housing related, Senator Proxmire emphasized that it is the type of lending (as well as the location) which would count under this Act:

In other words, if a bank is doing a vigorous job of promoting credit cards in the local community at 18 percent interest, that is one thing. If they are promoting mortgages, that is something different. (Hearings at 226)

When a representative of the American Bankers Association testified, he also expressed an opinion that the CRA was "intended to help revitalize and rebuild the housing and economic base of communities threatened with deterioration"<sup>35</sup> and at one point Senator Proxmire said that rehabilitation by the private sector is "what the bill is all about" (Hearings on S.406 at 333).

The interchange between Senator Proxmire and a representative of the Bowery Savings Bank illustrates the degree to which it was apparently the sponsor's intention to emphasize single-family mortgage lending

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<sup>30</sup> Congressional Record, daily ed., January 24, 1977, at S.1202.

<sup>31</sup> Hearings on S.406 at 17.

<sup>32</sup> Id. at 152-153.

<sup>33</sup> Id. at 159.

<sup>34</sup> Id.

<sup>35</sup> Hearings 150on S.406 at 314.

activity under the CRA. The representative from Bowery had testified that his Bank provided substantial funds for multi-family construction and for other services that form part of the "infrastructure" in a community, in this case funds for the Urban Development Corporation in New York. While commending this activity, the Chairman pointed to the small amount of mortgage lending and characterized the Bank as "lagging behind in local community investment." He suggested that the CRA would provide helpful new criteria to guide the witness's lending policy (See Hearings on S.406, pp. 369-394).

In the Committee Report on the Housing and Community Development Act the panel set forth an example of one state regulator which "tied more liberal branching policy to requirements that lenders branching from city to suburb emphasize lending to the inner city areas as a precondition for approval of the new suburban branch." (emphasis added) This, it was stated results in the suburbs gaining "a more competitive banking environment" and "the city gains an institution more sensitive to re-investment." (Committee Report at 34) This example, impliedly, represents the type of action expected to be taken under the CRA by federal agencies.

Finally, Senator Lugar, an opponent of the Community Re-investment title, in debate on an early version of the Act, pointed out the difficulties with defining the phrase "community." He suggested that it be defined "very broadly," as indeed, it ultimately was in the final version. Senator Lugar's comments help illuminate the intention of the bill's sponsors in proposing the CRA:

The intent of those who spoke in favor of Title IV in committee sessions was to take a look at neglected inner city areas or other depressed areas, for that matter, of suburbia or rural America, areas in which there are many houses and many persons reportedly wanting to have loans, with the inability to mesh together the institutions which are close by, these properties.<sup>36</sup> (emphasis added)

#### **IV. GENERAL POLICY CONSIDERATIONS IN IMPLEMENTING THE ACT**

Although the thrust of the Community Re-investment Act may be to encourage loans which contribute to the revitalization of areas threatened with decline, with an emphasis on housing finance, the mechanics for accomplishing this goal are not spelled out in the Act. In the original version (Appendix A) the mechanism for implementation was contained in Section 4. After setting forth a statement of purpose in Section 2, the bill provided for each federal financial supervisory agency to "develop programs and procedures for carrying out the purposes of the Act" and provided a list of minimum criteria to be included. The final version of the CRA simply directs each agency, in connection with its examination of an institution to "assess" the institution's record and "take such record into account" in considering the various applications defined in Section 3. Under both versions, the agencies were directed to draft regulations to "carry out the purposes of this title" (Section 6, now Section 806).

There is considerable comment in the record about the intended consequences of the change in Section 4 and about the intentions of the sponsors of the act with regard to the impact of the new law on established procedures. The point was frequently made that the Act was not intended to inject hard and fast rules or ratios into the examination process or the evaluation of "applications for a deposit facility." In fact, the sponsors of the bill made considerable efforts to emphasize that the Act was to be carried out using existing record keeping mechanisms and with due regard for other criteria which must be taken into account. In some respects, the bill is described almost as a "sensitizing" tool intended to "raise the consciousness" of lenders and regulators, and gently lead them toward a greater awareness of urban lending needs.

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<sup>36</sup> Congressional Record, daily ed.,-June 6, 1977, at S.8960.

In his statement introducing S.406 into the Senate, Chairman Proxmire said:

. . . This does not mean that the regulators would consider community credit services as the only factor in approving or denying deposit facility applications.

On the contrary, the agencies would continue to apply the criteria they have traditionally used for approving deposit facility applications, as spelled out under existing law and regulations. These include the financial history and condition of the bank, the adequacy of its capital structure, its future earnings prospects, the general character of the management, and the convenience and needs of the community to be served.

The bill would not inject any significantly new element into the deposit facility application approval process already in place. Instead, it merely amplifies the "community need" criteria already contained in existing law and regulation and provides a more explicit statutory . statement of what constitutes "community need" to make clear that it includes credit needs.

\* \* \* \*

The bill is not intended to force financial institutions into making high-risk loans that would jeopardize their safety . . . . There is no reason to assume that a higher degree of community reinvestment is incompatible with bank safety. Rebuilding and revitalizing communities threatened by decline is good for the communities and good for banking (Congressional Record, daily ed., January 24, 1977, at 1202-1203.)

During the Hearings on S.406, Proxmire explained:

What this bill would do would try to make the banks more sensitive then they have been in the past to t cir responsibilities to provide for local community needs. Obviously, as was indicated by some of the witnesses, the sanction is a relatively weak sanction.- (at 154) (emphasis added)

Mr. Proxmire characterized the bill and its system of rewards through the evaluation process as a "mild proposal" (Hearings at 323) and a "mild incentive" (Hearings at 326).

During the mark-up session, Senator Heinz said that the Act would simply "begin a mental process" -of "thinking through the problems of urban areas."<sup>37</sup>

The Act calls for a subjective analysis by the supervisory agencies of the record made by an institution, with considerable flexibility permitted to accommodate varying circumstances. Again, at the Hearings, Proxmire stated:

If they can show that the community where they haven't made the loans is not a community in which they could make sound loans I think that would be a complete and adequate answer. But if you have competing banks, one bank has a

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<sup>37</sup> Mark-up Session Transcript, Community Development and Housing Legislation for 1978, Vol. V, Monday, Play 9, 1977 (Available at offices of Senate Committee on Banking) at 292.

good record of making loans; the other has not, in the local community, then preference would be given under this legislation to the bank that has the better record . . . or . . . [one] . . . with some kind of affirmative plan which they could show in the future that they intended to make community loans. (Hearings on S.406 at 154)

Repeating this theme, Chairman Proxmire approaches the bill as "limited" and not intended to "reach as far as housing is concerned, everyone" (Hearings at 225). Also, as far as "business groups" are concerned, it would have "limited application," with the expectation that the Small Business Administration exists to make subsidized business loans. (Hearings at 225. See also Hearings at 293.)

In an exchange with a lender who testified on S.406, Senator Proxmire reinforced the flexible approach of this legislation.

*I'm not saying you have to have 95 or 100 percent of your loans in the local community. You might have 50, 40, 30 or less. If the situation in the local community was fully met, you may have less. (Hearings at 392)*

In another exchange with a lender discussing the balance between investing locally or in securities, the Senator said:

*I am not saying put everything in the local community. There may be situations where you can put in 10 or 5 percent. This bill says where there is a local credit need, where the need is sound, it should be provided for, (Hearings at 321).*

As to the necessity for additional record keeping, it appears to be a fair observation that Congress did not intend to add substantial record keeping requirements to the application process. In the Committee Report on 406, it states (at 34)

*As originally introduced, S.406 would have required the filing of certain additional material. The Committee was informed that substantial data is already filed in connection with both charter applications and applications for new deposit facilities, and after a full discussion, concluded that these additional reporting burdens would not be necessary or appropriate to the enforcement of this Title.*

It was the clear purpose of Congress to build not only on existing reports made in connection with particular applications by lenders but to require the regulators to look at and evaluate, in connection with applications and examinations etc., actual loan files and records kept pursuant to preexisting consumer protection laws, in lieu of requiring new types of reporting.

Loan files are already available to examiners in periodic examinations of financial institutions. These files, of course, indicate where loans are made. They will reveal whether a disproportionate amount of credit is being provided outside of the institution's local territory. The Equal Credit Opportunity Act, as implemented under regulation B, requires that loan applications be retained, and these will provide one indication of local loan demand. The ability of competing institutions to find loan opportunities locally also reflects local credit demand. Finally, in the case of mortgage loans, the flame Mortgage Disclosure Act provides a precise

breakdown of the geographic distribution of mortgage loans. Committee Report at 34.

This is a significant requirement, for while it does not increase the paperwork burden it mandates a change in the essence of the evaluation process, and mandates the use of tools that had been previously available, but not previously aggregated for use in this way.

While the impact of the Act on record keeping and reporting should not be to increase the burden on institutions it may "change to some extent the kind of information they would supply" (Proxmire, Hearings at 293). The mark-up transcripts deal in depth with the decision to drop the reporting requirements, and, during the mark-up session, Senator Proxmire noted that the revised approach is intended, not just to require less reporting, but to inject more capacity for flexibility into the regulation writing process (Vol. V, P. 352).

When he introduced the basic amendment which changed Section 4 during the mark-up session, Senator Proxmire pointed out that the original version "would not have required significant reporting burdens since most of the data already exists. The idea was to require the regulators to analyze existing data in connection with branch applications and supplement it where necessary. But the amendment I am offering makes it absolutely clear that no additional reports are to be required" (emphasis added) (Mark-up Transcript, Vol. IV, p. 283).

Later in the mark-up session the Senators discussed the possibility that the regulatory agencies might use the general language of Section 6 as a lever to impose extensive additional reporting requirements. While the opponents of the bill feared that this would occur, the supporters of the bill appeared certain that by deleting the reporting elements of Section 41 they had insured against this. (Mark-up Transcript, Vol. V, Tuesday, May 10, 1977, at 352-357).

In debate on S-406 Senator Proxmire discussed this decision and said:

The committee considered this provision in mark-up, and we unanimously agreed that bank examiners already have access to ample data to carry out the purposes of this title. We deleted the reporting requirement.<sup>38</sup>

If Congress did not intend for the supervisory agencies to obtain additional reporting pursuant to the CRA, and if, in the preamble to the Act Congress found that regulated financial institutions are already required by law to demonstrate that they are serving the conveniences and needs of their communities, including credit needs, the question arises as to how Congress intended this Act to change the way that things are done.

It appears from the legislative history that, rather than being a redundancy, passage of the Community Re-investment Act was a Congressional rebuke to the four federal financial regulatory agencies and a directive to them to shift their supervisory emphasis to include consideration of urban lending obligations of chartered and insured institutions, and to regard such obligations as a matter of basic structure in the banking system - as an inherent component of the "public purpose" for which institutions are chartered.

In the Committee Report it states: (at 33-35)

The Committee believes that existing law provides general authority for the financial supervisory agencies to emphasize to institutions that their main obligation is to their primary service areas. The need for new legislation arises

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<sup>38</sup> Congressional Record, daily ed., June 6, 1977, S-8958.

because' regulating agencies lack systematic, affirmative programs to encourage lenders to give priority to the credit needs of their home areas.

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It is clear that, given the will, regulators can use their authority to examine and to approve charters, branches, mergers, acquisitions, and insurance of accounts to encourage lenders to meet community credit needs.

\* \* \* \* \*

Furthermore, all of the regulatory agencies filing comments on this bill agreed in principle that "convenience and needs" includes credit needs. To that extent, this Title merely reasserts a long-standing policy that has been almost ignored by the regulators. Similarly, despite the opposition of some segments of the financial industry, especially to the original language in Section 4 which the Committee deleted, there is a general consensus that institutions do have an obligation to their local areas.

Title IV amplifies existing law to make clear that Federal financial regulatory agencies processing applications for charters, branches, mergers, holding company acquisitions, or insurance of accounts are to use their regulatory authority to encourage institutions to meet community needs, including credit needs.

Charters have never constituted licenses to ignore local credit needs. Therefore, the Committee rejected the assertion that this Title allocates credit. It simply underscores the long-standing obligation to an institution's local service area implicit in existing law.

At the hearings on S.406 each of the four agencies contended that they were already taking steps to assure that community credit needs were being met. Passage of the act despite extensive presentations and correspondence from the agencies fairly indicates. Congressional dissatisfaction with the manner in which the federal agencies were proceeding. For examples of such dissatisfaction see Hearings on S.406 at 294, 327, 397, 398. ("The three bank regulatory agencies have never sanctioned a bank or failed to approve a branch application because the bank was failing to meet community needs," at 327) (The Comptroller's decision on South Shore bank is the only decision of its kind." at 397)

Finally, in the mark-up session, Senator Morgan's motion to delete the Community Re-investment Title from the Housing and Community Development legislation was defeated by a tie vote of 7 to 7. Senator Morgan then moved to poll the Committee and Senator Sarbanes responded, defending the amended version of the Act and observed:

Now the citation from the national bank charter application and the citation of the Marston testimony are in effect contentions that they can require this as is and therefore do not need the bill in order to do it. The fact is they haven't been doing it and the reason we have this bill as amended in its weakened form is to make sure that it's included as one of the criteria. I think it's clear that the agencies who

implement the regulation want to do far less than what was specifically in the bill  
. . . . (Transcript of Markup Session, Tuesday, May 10, 1977, Vol. V, p. 355.)

## V. THE COMMUNITY RE-INVESTMENT ACT IN THE CONTEXT OF THE FEDERAL REGULATORY FRAMEWORK

### A. Background

The Community Re-investment Act has been "superimposed" upon a complex pre-existing regulatory scheme. The lynch-pin which connects the Act to existing standards and criteria is the phrase "convenience and needs of the community." Congress chose this criterion, which is contained in other laws affecting bank regulation, to carry out its goals on the premise that the presence of the phrase in other statutes created a "continuing and affirmative" obligation on the part of lenders to meet the credit, as well as deposit needs of their areas. (Section 802) The CRA covers several types of applications by financial institutions (it also omits several types of activities, which indicates one of the weaknesses of attempting to build new enforcement mechanisms on top of the current bank regulatory structure.) The activities covered by the CRA include:

- (a) a charter for a national bank or federal savings and loan association.
- (b) deposit insurance granted by FDIC or FSLIC to newly chartered state banks, savings banks and savings associations.
- (c) the establishment of a domestic branch or other facility with the ability to accept deposits.
- (d) the relocation of a home or branch office.
- (e) merger of a commercial bank or savings association requiring agency approval.
- (f) acquisitions covered by the Bank Holding Company Act or the approximately comparable provisions of the National Housing Act, for savings associations.

The applications not covered include the following.

Entry into the Federal Reserve System is not covered. Neither are credit unions which, due to now statutory powers, are *soon to* enter the long-term residential mortgage market and secondary markets. Also, the branching decisions of state chartered savings and loans are not reached at all, because FSLIC has no regulatory authority in such circumstances. Consequently, approximately one half of the savings and loan assets *in* the nation are not covered through the branching provisions of the Act and conceivably, this may encourage conversion of federal associations to state status. Also, the FSLIC's ability to withhold insurance at all on the basis of community need has been questioned in recent litigation.

The branching decisions of National Banks may also be excluded under the CRA because of the provisions of the McFadden Act of 1927, which ties branching of National banks to state law. Further the banks and savings associations located in non-branching states will obviously not be subject to evaluation under CRA on their branching decisions, which may weaken coverage of the Act. Also, the CRA covers applications for FDIC and FSLIC insurance only from "newly chartered" as opposed to existing institutions, (but this is not expected to be a major problem). Further, recent litigation now before the Supreme Court calls into question the discretion of the FRB in any event to deny an application to become a *bank* holding company. At the same time, litigation involving the FHLBE, implies that in ruling on limited branch applications the Board has so much discretion that it need not be held to the basic criteria of the Homeowner's Loan Act, including the community need criteria.

Although the weaknesses of the CRA enforcement scheme may be the weaknesses of the financial regulatory structure in general, the strength of this if superimposed" approach is that each of the "covered

activities" are connected through the operation of the examination process, the basic information gathering and auditing tool utilized by each agency to evaluate applications for change in bank structure, and to monitor general bank conditions. The Supreme Court has described the follows:<sup>39</sup>

. . . perhaps the most effective weapon of federal bank regulation is the broad visitatorial power of federal bank examiners. Whenever the agencies deem it necessary, they may order a 'thorough examination of all of the affairs of the bank' whether it is a member of the FRS or a nonmember insured bank . . . . Such examinations are frequent and intensive. In addition, the banks are required to furnish detailed periodic reports of their operations to the supervisory agencies . . . . In this way the agencies maintain virtually a day-to-day surveillance of the American Banking System. And should they discover unsound banking practices, they are equipped with a formidable array of sanctions . . . .

As a result of the existence of this panoply of sanctions, recommendations by the agencies concerning banking practices tend to be followed by banks without the necessity of formal compliance proceedings.

An excellent overview of existing enforcement mechanisms and how they work is contained in the Study on Federal Regulation of the Senate Committee on Governmental Affairs (Vol. V, Chapter 6, Banking Regulation at 217):

Where an examiner finds deficiencies . . . attempts to remedy them are first made informally, through what is sometimes referred to as moral suasion. That is, the problems are called to the attention of the bank's management. The management is then expected to correct them. If a simple exhortation by the examiner proves ineffective, the regulatory agency may then bring the matter up with the bank board of directors. Other informal means of enforcement include requests that the bank make periodic progress reports, special examinations to monitor specific problems, rejection of a bank's application for a new branch, public disclosure by the regulatory agency of the bank's problems or a threat of legal action.

In the event that any or all of these informal enforcement mechanisms fail, the regulatory agencies have several formal sanctions to apply. These options differ in their force. The least coercive is a formal written agreement which confirms the bank's plans to correct problems. Both the agency and the bank sign it. If the agreement is violated, the agency has grounds to issue a cease and desist order. Between 1974-76, the Comptroller entered into 58 voluntary agreements, the Fed into 5 and the FDIC entered none.

Under 12 U.S.C. 1818(b), the Financial Institutions Supervisory Act, the three agencies may issue cease and desist orders against banks to cause problems to be corrected. Once an order becomes effective, it remains in effect until it is set aside by the agency or a reviewing court. Between 1971-76, the Comptroller issued 20 cease and desist orders, the Fed issued 9 and the FDIC issued 67.

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<sup>39</sup> United States v. Philadelphia National Bank, 374 U.S. 321, 329 (1963). The anti-trust ruling in this case was reversed by subsequent amendments to the Bank Merger Act, but the observations of the Court with respect to the bank regulatory process, set forth above, are nonetheless insightful.

The next most forcible action is removal of management, which authority is granted under 12 U.S.C. 1813(e). An order to remove a bank director or officer may be issued when (1) he or she has violated a law, rule regulation, or final cease and desist order; has participated in an unsafe and unsound banking practice; or has committed or engaged in an act, omission or practice which constitutes a breach of fiduciary duty; (2) the bank has suffered or probably will suffer substantial financial loss or the interests of depositors may be prejudiced; and (3) the violation involved personal dishonesty.

Finally each of the agencies has the authority to cease providing its particular benefits. That is the FDIC may terminate insurance. The Fed may cancel membership. And, the Comptroller may revoke a national bank charter.

The general regulatory scheme for savings associations FSLIC or chartered as federal associations is very similar. Particularly with respect to federally chartered institutions, the Bank Board has a plenary "cradle to grave" authority.<sup>40</sup>

By structuring the Community Re-investment Act as it has, Congress intended to harness this entire enforcement apparatus already in place and it is anticipated that Community Re-investment Act considerations will become a part of each regularly scheduled examination.<sup>41</sup> However, since the considerations spelled out in Section 804 are intended to be only one of the criteria to be considered they must be balanced with other aspects of "convenience and needs." It is helpful therefore to analyze the current impact of "convenience and needs" as a criterion under existing rules.

## **B. Origin And Use Of Phrase "Convenience and Needs"**

The phrase "community convenience and needs" first appeared in the federal banking statutes in 1935 and related to the FDIC.<sup>42</sup>

The provision in which it appeared survives today as 12 U.S.C. §1816. It provides:

The factors to be enumerated in the certificate required under Section 1814 of the title and to be considered by the Board of Directors under Section 1315 of this title shall be the following: the financial history and condition of the bank, the adequacy of its capital structure, its future earnings prospects, the general character of its management, the convenience and needs of the community to be served by the bank and whether or not its corporate powers are consistent with the purposes of this chapter. (emphasis added)

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<sup>40</sup> See 12 U.S.C. §1464 and cases there cited. Also *Central Savings and Loan Association v. Federal Home Loan Bank Board*, 293 F. Supp. 617 (S.D. Iowa 1968) aff'd 422 F.2d 504 (8th Cir. 1970) *Bloomfield Federal Savings and Loan Association v. Federal Home Loan Bank Board*, 396 F. Supp. 384 (D. Neb. 1975). See also legislative history of FHLBB enabling legislation, e.g. 75 Congressional Record 12722-2 (1931) (Senator Goldsborough) ("The Board has absolute control over the institutions.")

<sup>41</sup> See Congressional Record, daily ed., October 1, 1977 at S.161 (Proxmire) (The agencies should "use the full extent of their authority, including their general regulatory authority . . .")

<sup>42</sup> The Federal Deposit Insurance Corporation was created in 1933 as an amendment to the Federal Reserve Act (June 13, 1933, 89, 48 Stat. 162). The phrase did not appear in the statute at that time. The Federal Reserve Act was amended by the Banking Act of 1935 (49 Stat. 684, 614) in which the phrase first appeared. The FDIC was removed from the Federal Reserve Act in 1950 and made a separate Act to be known as the Federal Deposit Insurance Act, Pub. Law 86 - 230. See 12 U.S.C. §1811.

The "certificates" referred to in the above passage are certificates that the criteria listed in 91816 are met, to be issued to the FDIC by the Comptroller, in the case of national banks, and by the Board of Governors of the Federal Reserve System in the case of state member banks, as a pre-condition of issuance of insurance by the FDIC. In the case of state non-member banks, the FDIC gives consideration to the same list of factors independently (see 12 U.S.C. S1815). Accordingly, the community convenience and needs standard now affects all three genre of commercial banks with federal contact.<sup>43</sup> (The same factors listed in §1816 are required to be considered by the FDIC in reviewing applications for branches and relocation of offices for state non-member banks, 12 U.S.C. 91823(d), and such banks cannot establish branches or relocate offices with-out FDIC approval.)

The legislative history of the Bank Act of 1935 reveals little about the original intended meaning of "community convenience and needs." However, it appears that the phrase was included in the Senate, but not the House version of that bill.

The Senate report states:<sup>44</sup>

Subsection (g) prescribes the contents of the certificate required to support an application by a bank for an insured status. The bill as reported enlarges upon the requirements in the bill as it passed the House by including other factors which are deemed proper for consideration in determining whether the applying bank should be insured. These factors are similar to those which are considered by the Comptroller of the Currency in authorizing national banks to commence business. (emphasis added)

The office of the Comptroller of the Currency was set up under the National Currency Act of 1863 and the National Bank Act of 1864.. However, the concept of "needs and convenience" of the community does not appear in those laws or in subsequent amendments to the National Bank Act previous to 1935. (or in the current Act, for that matter, 12 U.S.C. 521 et seq.)

A possible explanation for inclusion of the phrase in the FDIC statute in reliance on the "Comptroller's standards" is that this concept of community convenience and needs was used in practice by the Comptroller at that time and was used by state banking authorities in early bank laws upon which the Comptroller's practices were based.<sup>45</sup>

The context for the origination of the phrase is important. Initially, in the 19th century, banks were formed by special acts of the legislature. The first "modern" banking statute, delegating responsibility to

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<sup>43</sup> An noted, the Community Re-investment Act contains a potential' significant omission. It does not require that its purposes be taken into account in connection with an application of a state bank to join the Federal Reserve System. Thus, although the Federal Reserve Board must certify "community convenience and needs" in connection with state member banks who apply for admission, it is not, by law, required to consider the requirements of Section 802 and 804 of the CRA in this regard. In one sense this omission is not serious because state member banks who apply for entry to the FRS will, most likely, be already insured by the FDIC. However, existing banks which move in and out of the system depending on changes in the regulatory climate or the reserve requirements will not be subject to review on CRA grounds at these junctures, and this eliminates one potentially important opportunity to review an institution's CRA record.

<sup>44</sup> Report of the Senate Committee on Banking and Currency, S. Report 1007, 74th Cong. (1935) at 3.

<sup>45</sup> The Courts have recognized that the Comptroller's discretion in chartering national banks is broader than a literal reading of the National Banking Act would indicate. See *City National Bank v. Smith*, 513 F.2d 479, 480 (D.C. Cir. 1975), fn. 6. See also the discussion of the Comptroller's ability to consider community need even though it is not in the text of the statute, *Pitts v. Camp*, 329 F. Supp. 1302, 1307 (D. S.C. 1971); vacated, 463 F.2d 632 (4th Cir. 1972); vacated, 411 U.S. 138 (1973) (Neither the 4th Circuit nor the Supreme Court disagreed with the district court's conclusions that the Comptroller could consider community need.)

administrative authorities was the New York Free Banking Act, in 1838.<sup>46</sup> The National Bank Act and similar laws in other states soon followed, but the banking system was still plagued by weaknesses, bank failure and by bank overcrowding. In 1908, New York amended its banking law to authorize the superintendent of banks to withhold approval of bank formation if the bank would not promote "public convenience and advantage." This was done against the background of the panic of 1907, in the wake of which many banks had failed. Other states had equivalent phrases in a variety of laws in the same time frame and they uniformly related to the issue of whether business in a community was "such as to demand or justify the establishment" of another bank because the establishment of too many banks "has a tendency to weaken and make unsafe all of the banks in . . . town" *Schaake v. Polley*, 118 P. 80 (Kansas 1911).<sup>47</sup>

In 1920 the "Instructions of the Comptroller of the Currency Relative to the Organization and Powers of National Banks" required the examiner investigating a bank which applied for a charter to consider the following factors in practice;

First, the general character and experience of the organization and of the proposed officers of the new bank; second, the adequacy of existing bank facilities and the need for further banking capital; third the outlook for growth and development of the town or city in which the bank is to be located; fourth, the methods and banking practices of the existing bank or banks, the interest rates which they charge and the character of the service which as quasi-public institutions they are rendering to their community;<sup>48</sup> fifth, the measurable prospects for success of the new bank if efficiently managed.

Stokes, in his article points out that when the 1927 McFadden Act gave the Comptroller discretion in approving branch applications, as a practical matter, "the convenience and needs of the community was an important factor in determining how he should exercise his discretion."<sup>49</sup>

Consequently, in drafting the 1935 legislation which codified community convenience and needs as a factor to be considered, it is probably fair to assume that Congress, relying on well established regulatory procedures at the time, was primarily addressing the requirement that the community be able to support the banking facilities to be chartered.<sup>50</sup>

As for savings and loans, the phrase "community convenience and needs" does not appear in the enabling legislation at all. 12 U.S.C. 51465(a) authorizes the Board to charter federal savings and loan institutions "giving primary consideration to the best practice of local mutual thrift and home financing institutions and to consider whether "there is a necessity for the proposed association in the community to, be served by it" and whether "there is a reasonable probability of usefulness and success of the proposed association." See also 12 C.F.R. Chapter V, §543.2(b). The FSLIC enabling law is seemingly even broader,

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<sup>46</sup> L. 1908 c. 125 §95.

<sup>47</sup> For an excellent discussion of the early construction of the "public convenience" consideration, see Stokes, *Public Convenience and Advantage in Applications for New Banks and Branches*, *Banking Law Journal*, Vol. 74, No. 11, November, 1957.

<sup>48</sup> It is interesting to note this early recognition of the principal that banks holding national charters are "quasi-public" in nature.

<sup>49</sup> Stokes, at 925.

<sup>50</sup>This concern for financial viability and possible bank failure runs throughout the hearings before the Subcommittee of the Senate Committee on Banking and Currency (74th Cong., April 19, to June 3, 1935,) on S.1715 and HR 7617. J.F. O'Connor, the Comptroller of the Currency at the time, referred in his testimony to the "convenience and needs" test as being necessary to "prevent over-banking in this country" at 145 and 182.

requiring consideration to be given to "all factors in connection with the financial condition of applicants . . ." 12 U.S.C. 1726(c)<sup>51</sup>

The FSLIC, through the Bank Board has historically taken the position that its authority to grant or withhold insurance to state chartered institutions was sufficiently broad to allow it to deny insurance on the basis of "community need." However, this assertion of authority by the Bank Board is now in question. State chartered organizations are, of course, subject to independent state determination of need, in connection with chartering and, in *West Helena Savings and Loan Association v. Federal Home Loan Bank Board*, 553 P.2d. 1175 (8th Cir. 1977) it was held that the authority of FSLIC to grant insurance is not superior to the state's authority to charter, and, as to state chartered associations, the Board's determination of economic need in the community cannot operate as a veto or override the determination of the state chartering authority. The Court took note of the fact that the FSLIC statute did not contain the phrase "convenience or needs of the community," as did the FDIC, or the phrase "community need for the service," as set forth for federally chartered associations. Court held that FSLIC was limited in denying insurance to state chartered entities, to the factors spelled out in 12 U.S.C. §1726.

It might appear as though this result would impair operation of the Community Re-investment Act insofar as it mandates federal consideration of community credit needs in granting FSLIC insurance. This is probably not the case for two reasons. First, the Community Re-investment Act itself provides the "missing" federal statutory authorization for the FSLIC to explicitly consider the community credit needs issue. This would suggest that had the CRA been enacted prior to the decision in *West Helena*, the decision would have been different. Also, among the explicit criteria already existing in 12 U.S.C. §1726 is whether the institution's home financing policies are "inconsistent with economical home financing." Given the legislative history of the CRA it is not implausible to argue that policies inconsistent with local credit needs, as that phrase is meant to apply under the CRA, are inconsistent with "economical home financing."<sup>52</sup>

In recent times, the term "convenience and needs of the community" has become a term-of-art in banking law. For example it is a statutory standard under the Bank Merger Act (see 12 U.S.C. §1828 (c) (5) (B)) . The scheme of this Act places responsibility for considering convenience and needs "in every case" on the agency which will supervise the surviving institution. It also must be considered by the Federal Reserve Board under the Bank Holding Company Act (see 12 U.S.C. §1842(c)). It also affects acquisitions by savings and loan holding companies (see 12 U.S.C. §1730 (e) (2) .)

In each of these uses of the phrase, it has come to be associated with traditional considerations of competition and sufficient "business" to assure the success of the bank, as oppose to any inherent obligation of the bank to the community's credit needs.

In measuring "convenience and needs" the agencies and the courts have looked to earnings, deposits, and "general overall services" such as larger lending limits and specialized banking services as indicia of compliance with this requirement. See *U.S. v. First National Bank of Jackson*, 301 F. Supp. 1161 (D.C.

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<sup>51</sup> The FSLIC was set-up in 1934 under the National Housing Act. This was after creation of the FDIC (1933) but before introduce of the concept of "community convenience and needs" into the FDIC Act (1935). The legislative history behind the FSLIC Act indicates a primary concern for halting the shift of deposits from uninsured savings institutions to insured FDIC banks, and protecting small savers. See Presidential Message to Congress =, May 14, 1934 (H.R. Doc. No. 371), 73<sup>rd</sup> Cong. 2nd Session (1934). See also 78 Cong. Rec. 11196 (1939) (Remarks of Rep. Reilly).

<sup>52</sup> The Anti-Trust Division of the Department of Justice has expressed interest in this and related matters and Assistant Attorney General Shenefield has publicly criticized the Board for following a policy which potentially limits entry to the industry. It is possible that the anti-trust policy and community re-investment policy of our nation's laws may be on a collision course. This potential exists particularly under the Bank Merger Act which provides for Justice Department review of proposed bank mergers.

Miss. 1969) and *Suburban Bank of Kansas City v. Jackson Co. State Bank*, 330 S.W. 2d 183, 187 (1959) ("one good indication of whether or not the convenience and needs of the community to be served justifies the respondent bank is the amount of deposits which the proposed bank would obtain during the first years of its operation. If the deposits and accompanying business of the bank are substantial, then the bank meets the convenience of the community and there is need for the bank.")<sup>53</sup> Under the Bank Merger Act Amendments of 1966 "community convenience and needs" became an important defense to alleged anti-competitive effects of proposed mergers. See *United States v. First City National Bank of Houston*, 386 U.S. 361 (1967). In *United States v. Third National Bank of Nashville*, 390 U.S. 171 (1968) the Court implied a fairly broad view of "community convenience and needs" encompassing many aspects of a bank's function as a "greater lending capacity." However, the court required specific findings of substantial benefit to the public to outweigh serious anti-competitive effects balancing function described in the Third National Bank case is delicate and somewhat subjective. The impact of the Community Re-investment Act will make this balancing function all the more complex.

The concept of community needs, as contemplated in the CRA will have to be taken into account, in addition to traditional approaches to convenience and needs. This should make it easier to overcome anti-competitive effects of mergers in some cases (e.g. where the banks can demonstrate an enhanced ability and commitment to urban revitalization efforts or local mortgage needs) and more difficult in others (e.g. where the disappearing bank may have been a community based organization). Conceivably, the structure of the, CRA could generate competition among lenders to demonstrate the greatest commitment to the local area in order to use the strong national policy behind the CRA to countervail the traditionally strong policy behind the anti-trust laws. This, it appears, is one of the intentions of the Act.

It should be noted, also, that even where anti-competitive aspects are not present in connection with a proposed merger, the Community Re-investment Act would apply, and an institution's record in this area will have to be taken into account. Thus, because of the CRA, the concept of community convenience and needs takes on an independent importance in Bank Mergers beyond being a defense to possible anti-trust problems.

It is not unknown for banks to "forum shop" by selecting supervisory jurisdiction under the agency with the most sympathetic approach to mergers. Another device utilized to avoid a narrow view on mergers is acquisition under the Bank Holding Company Act, instead of merger, in order to be subject to the more liberal approach of the Federal Reserve Board on issues of competitiveness. Accordingly, it is important that the banking agencies, particularly the Fed, have compatible policies under the CRA to avoid this, and to avoid the occasional "competition in laxity" known to affect these agencies from time to time.

With respect to branching, community convenience and needs naturally has had a meaning similar to its meaning in other contexts. For instance, the Manual of Examination Policies of the Federal Deposit Insurance Corporation states:<sup>54</sup>

## 5. Convenience And Needs Of The Community

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<sup>53</sup> As of March 14, 1975 the Board of Governors of the Federal Reserve Board had not decided whether the community convenience and needs test included "equal lending policies" as "relevant considerate and regarded the test as referring to "the quality and quantity of financial services provided in the community." (From exchange of correspondence between Brenton C. Leavitt, Program Director for Banking Structure, Federal Reserve Board (March 14, 1975), Mr. Lloyd W. Bostian Jr., Vice President, Federal Reserve Board Richmond (2/3/75) and Mr. Theodore Cross, Editor of *Business a Society Review* of Now York. (Letters on file with Federal Reserve Board and with author)) . On balance one should also note a circular issued by Mr. Leavitt on March 6, 1973 (SR-201) to t1officers in charge of examination at each Reserve Bank, pointing out that the Board recognizes that a bank's obligations to its community may require the making of some loans below normal standards and that this was permissible in order to improve the social climate of the community.

<sup>54</sup> Section U, Applications to Establish a Branch or Move Main Office or Branch, Revised 8/12/74.

Where the application is to establish a new branch, the guidelines and considerations outlined under this factor for application for deposit insurance by proposed or newly organized banks apply insofar as pertinent.

In the comparable section in the "Application for Deposit Insurance"<sup>55</sup> to which the branching section refers, it is stated:

F. Convenience And Needs Of Community

The Corporation criteria under this statutory factor are closely related to those outlined with respect to the "Future Earnings Prospects Factor." A going institution which is being successfully and profitably operated, and which has a recognized place and established customer relationships in its community, is for self evident reasons convenient to and fulfilling the needs of the community it serves. (emphasis added)

This section also provides:

E. Convenience And Needs Of The Community To Be Served

Generally, there is a presumptive indication of need if the directors or organizers of the applicant are a responsible group of men<sup>56</sup> willing and able to supply a substantial and adequate amount of money to back up their judgment.<sup>57</sup>

The FDIC application to establish a branch states:<sup>58</sup>

The applicants are responsible for developing the legal factor convenience and needs of the community in a way which clearly shows the economic support and justification for the proposed branch. (emphasis added)

The directions given and information requested here are revirtually identical on the FDIC Application For Proposed New Bank.<sup>59</sup>

As to branching for savings and loans, it has already been noted that the FSLIC has no authority to pass on the branching decisions of state-chartered associations. In addition, the law with regard to federally chartered institutions is silent on the issue of branching. The authority of the Board to regulate branching of federal associations, however, has been judicially established. See *Lyons Savings and Loan Association v. Federal Rome Loan Bank Board*;<sup>60</sup> see also *North Arlington National Bank v. Kearney Federal Savings and Loan*<sup>61</sup> and *Springfield Institution for Savings v. Worcester Federal Savings and Loan Association*.<sup>62</sup>

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<sup>55</sup> Revised March 18, 1974.

<sup>56</sup> This uni-sexual reference to organizers and directors of banks seems hardly consistent with the spirit of the Equal Credit Opportunity Act, which the FDIC administers, or Title VII of the Civil Rights Act of 1964, to which its regulates are subject.

<sup>57</sup> It is unlikely that this trusting approach to approval is adequate under the CRA to determine if the institution is truly meeting credit needs and a more incisive investigation is probably called for.

<sup>58</sup> FDIC Form 6210 (10/73) at 8, formerly form 85.

<sup>59</sup> FDIC Form 6200/05, (6/74), formerly form 82.

<sup>60</sup> 337 F. Supp. 11 (D.C. Ill. 1974).

<sup>61</sup> 187 F.2d 564 (3rd Cir. 1951), cert. den. 342 U.S. 816 (1951).

In practice, the FHLBB has incorporated into branch application evaluations the three factors listed for charter consideration under 12 U.S.C. 91464(e), including whether "a necessity exists for such an institution in the community to be served." (See testimony of Garth Marston, Hearings on S.406 at 240).<sup>63</sup>

It has been held that the Board's control over branching of federal associations is plenary and that unlike the Comptroller of the Currency, the Board is not bound by the principle of "competitive equality" which limits federal branching to the same extent that state laws limit state branching (see, e.g., United States ex rel Wisconsin v. First Federal Savings and Loan Association.)<sup>64</sup> However, despite the Board's authority to permit branching of federal associations even in non-branching states, the Board in 1952 adopted and continues to follow a general policy of not permitting branches in states where they have been denied to state-chartered savings associations. See 12 C.F.R. §555.6(b) and 12 C.F.R. 545.14(b). Exceptions to this policy exist for merged associations which were merged for supervisory reasons and for associations which would be located in a "low-income, inner city area which is inadequately served by existing savings and loan facilities." This exception is very significant for CRA purposes and is an example of the kind of regulatory approach probably favored under the Act. It has been observed that this approach on the part of the Bank Board has also influenced state regulators and has opened up state branching to some extent, (so as not to put state-associations at a competitive disadvantage.)<sup>65</sup>

The issue of "competitive equality" does not have similar policy exceptions when applied to branching of national banks. Under the so-called McFadden Act, national banks can branch "only when, where and how" state law authorizes a state bank to establish a branch."<sup>66</sup> In Hemstead Bank v. Smith, 540 F.2d 57, 59-60 (2nd Cir. 1976) it was held that the Comptroller not only must consider whether the state allows branching in some form, "but must also, in each case, make such specific findings as are required by state law." This state of affairs raises questions for implementation of the Community Re-investment Act. If a state's approach to convenience and needs" is different from that traditionally used by the Comptroller, (which is to be adjusted under the CRA,) does the CRA now mandate that the Comptroller's decision supersede the result under state law? In other words, does the Community Re-investment Act modify the McFadden Act, or does it operate subject to the policy of the McFadden Act?<sup>67</sup> Again, there exists a potential conflict between a law aimed at "competitive equality" and a law with a strong public purpose of serving urban needs. Other questions are also

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<sup>62</sup> 329 Mass. 184, 107 N.E. 2d 315 (1952).

<sup>63</sup> Apparently, the FHLBB may have the discretion not to include community convenience and needs in its consideration of limited branch offices to the same extent that it considers it in regular branching, City Federal Savings and Loan Association v. Federal Home Loan Bank Board, (75-C-343, D.C. E. Wis, 10/18/77); 12 CFR §545.14(J). It is possible, however, that the CRA takes this discretion away, as to the CRA aspects of application evaluation.

<sup>64</sup> See 151 F. Supp. 390 (E.D. Wisc. 1957) modified on other grounds 248 F.2d 804, cert. den. 355 U.S. 957 (1958). See also Bank of Ozark v. Federal Home Loan Bank Board, 402 F. Supp. 162 (E.D. Ark. 1975).

<sup>65</sup> See Harth, Additional Offices and Facilities of Savings Associations, Legal Bulletin, Vol. 2, No. 8, May 1974, United States League of Savings Associations.

<sup>66</sup> See 12 U.S.C. §36(c); First National Bank of Plant City v. Dickerson, 396 U.S. 122 (1969) and First National Bank of Logan v. Walker Bank and Trust Co., 385 U.S. 252 (1966).

<sup>67</sup> The legislative history is not very helpful on this point. While Congress clearly intended to change the way that the agencies looked at convenience and needs, it utilized the mechanism of existing procedure. Since Congress knew about the competitive equality controversy in national banking law, it probably should not be assumed that it intended to modify this structure without expressly saying so. On the other hand (the direction contained in the CRA is not qualified, and it can be argued that, knowing of existing procedure, Congress intended to change it by requiring an §804 review in all branch applications. The confusion is enhanced by reference to Senator Proxmire's remarks on the floor of the Senate when introduced (the Conference Report on 11.11. 6655. Congressional Record, daily ed., October 1, 1977 at §16114. Discussing the differential impact of the law on state and federal entities, he observed that the greatest impact would be on federally chartered institutions, and as to state institutions, the agencies were to also use "the full extent of their authority." he said I would like to make it clear in the Record today that the enumerated regulatory agencies take the required assessments into account in all their authorized actions regarding state chartered institutions as well as federally chartered institutions"(emphasis added). The Chairman may have been referring to actions previously authorized under existing bank statutes and regulations, or to such actions as are authorized in the CRA itself.

raised by the interface of these two laws: If a state (such as New York, Massachusetts, Connecticut or California) has a community re-investment" Aspect to its own branching rules, and these rules are more extensive than those under the federal community re-investment title, is the Comptroller required to utilize the state standard, in order to maintain the "competitive equality"? Under present law, it would appear that this is the case.

In a state which has no comparable community re-investment rules, it might be argued that to maintain "competitive equality," the Comptroller cannot apply the federal standard because state banks would not be subject to the same requirement. This argument, however, does not appear to be valid. Most state banks will be subject to the Community Re-investment Act evaluation through their membership in the FDIC or Federal Reserve System. If this is the case, then "competitive equality" is maintained only if the Comptroller applies the federal CRA standards to national banks.

An interesting dilemma arises if the FDIC or Fed rules under the CRA differ significantly from the Comptroller's rules. In that circumstance, the goals of the McFadden Act would be subverted because different types of banks will be subject to differing competitive standards and it is not implausible to envision a bank suing the regulatory agency having tougher rules. This might provide a strong incentive for the banking agencies to coordinate their approaches to community re-investment. On the other hand, it might generate a renewed round of "competition in laxity."

In summary, three observations seem appropriate.

First, the Community Re-investment Act does not contemplate or require the regulators to abandon traditional definitions of convenience and need. Consequently, these traditional concepts must be articulated and understood in context, because they will have to be balanced with new approach to community convenience and need.<sup>68</sup>

Second, the mechanisms for evaluating community convenience and needs which are currently in place will have to be adapted to serve the purposes of the new act, so it is important to understand the use and the potential use of these existing mechanisms.

Third, even though Congress did not require abandoning the traditional convenience and need criteria it certainly rebuked the agencies for approaching the issue so narrowly in the past. Accordingly, many examples of the traditional approach provide teaching examples of the approaches which Congress expressly wished to improve upon or modify, and it will not be sufficient under CRA simply to continue with past practices.

## **VI. A REGULATORY APPROACH TO COMMUNITY RE-INVESTMENT**

The analysis which has preceded this section provides background for exploring an approach to dealing with the Community Re-investment Act.

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<sup>68</sup> One of the most comprehensive statements of the traditional convenience and needs concept appears in *Bank of New Bern v. Wachovia Bank & Trust Co.*, N.A. 353 F. Supp. 643 (D.C. N.C. 1972), pursuant to a state banking statute. The considerations enumerated there included (1) whether existing banks provide a full complement of banking services at competitive rates and fees, (2) whether there is a need for specialized services not presently available, (3) leadership and participation in economic growth of community by management of exist banks (4) composition of population and prospects for further growth (5) nature and strength of economy and its prospects for growth, (6) extent to which competition will stimulate economy and make for more healthy banking business and (7) extent to which entry of new bank has public support in community.

## A. Defining Community

Under the final version of the Act, this may be the simplest part of promulgating rules because it is not necessary to construe the troublesome new proposed term "primary savings service area." By switching to "entire community" the CRA incorporates the general approaches to setting geographic boundary patterns used traditionally by each agency in defining service area or market area, and used by the courts for the same purpose. Generally it is the area defined by the institution itself for these purposes. By including the reference to "low and moderate income neighborhoods" Congress simply provided a safeguard against "gerrymandering" out all but the most affluent areas in defining community<sup>69</sup> and expresses a definite emphasis on "neighborhoods which is a phrase having its generic meaning, and is not a term of art. The legislative history of the CRA makes it clear that no hard and fast rules are intended -- and definitions will vary depending on type and location of the institution and the general community in which it is located. Generic rules of thumb are already in place at the four agencies and can be adept comfortably, keeping in mind the purpose of the inquiry and the emphasis on the needs of "neighborhoods." Dealing with a flexible concept of "community" is not a new task for bankers or regulator., For instance, in his 1957 article, Stokes points out that "with the exception of the rare instance of a statutory definition to the contrary, the word "community" does not mean municipality, but rather refers to a geographical segment which for banking purposes is regarded as a unit" (Stokes, op. cit fn. 4 at 932).

The Comptroller of the Currency presently utilizes a concept of "primary service area."<sup>70</sup>

Primary Service Area. Within the broader concept of a market, the applicant should delineate a Primary Service Area (PSA). The dimensions of the PSA will necessarily vary with the type of market to be served. A rural bank may serve a relatively large area if banking alternatives are limited; conversely, the PSA of an urban bank may be limited to several city blocks. The PSA is defined as the smallest area from which the bank expects to draw approximately seventy-five percent of its deposits and should be drawn around a natural customer base. It should not be unrealistically delineated to exclude competing banks or to include areas of concentrated population. Barriers to access such as major highways, rivers, mountains or other impediments should be considered.

The National Bank Application<sup>71</sup> requires delineation of the boundaries of the PSA and requires two maps showing locations of competing institutions as well as "housing developments, shopping centers, commercial and industrial facilities . . ." To place the relevant market in context, a specimen map requires the applicant to find that point in the PSA which is furthest distant from the proposed office, and then to draw a circle with a radius one and one half times that farthest distance, with the office at the center. The application also requires a detailed analysis of census data, breaking down the population size, median age, median income, number of dwelling units and renter occupied units as a percentage of total dwelling units, occupancy rates, median values, dollar volume of building, activity, unemployment rates, and retail sales for the PSA and the city, and in some instances, the county and the SMSA. The form requires analysis of the location and size of

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<sup>69</sup> The CRA requires the agency not to accept at face value the applicant's delineation of market or service area. For instance, an institution with home offices in mid-town Atlanta should not be able to target its market area as "20 miles north of the Capital Building" and neglect the integrated and sometimes less affluent communities which exist in the southern part of Fulton and DeKalb counties. At the same time, a small institution which only operates in a northern suburb and has been so locate might be able to justify a limited definition of community which does not include the Greater Atlanta metropolitan area. The institutions own marketing pattern (local or regional) will be a helpful guide.

<sup>70</sup> Department of the Treasury, Comptroller of the Currency, Policy Statements on Corporate Activities, (Bank Charters, Branches, Conversions etc., June4, 1976 (41 FR 22602)).

<sup>71</sup> CC Form 7020-02.

employers and shopping centers as well as information on zoning, planning and environmental restriction and an estimate of the amount of land devoted to residential and other uses. One question asks the applicant to "describe other plans to enhance the convenience and needs of the community(s) to be served".

It would not be a difficult adaptation to use the above information to evaluate community needs as contemplated under the CRA. The map delineating the PSA could require identification of areas of "low and moderate" income by requiring a lay-over or shaded key, indicating median income for the various communities covered. "Neighborhoods" formed by natural boundaries or commercial centers and neighborhoods which are traditionally ascertainable can be identified. Information about single and multi-family housing stock is also easily integrated into the present application. The question on community convenience and needs can be designed to inquire into the applicant's intentions and plans with respect to identifying the local credit needs of the market area and its Various neighborhoods as defined for CRA purposes and meeting them.

The Comptroller's application for a proposed branch is -almost identical to the application for charter in regard to soliciting information on the PSA,<sup>72</sup> and likewise can be adapted.

The Federal Reserve Board does not have a standard form for branching -- branches are applied for by letter request. However, form F.R. Y-1, for prior approval to become a bank holding company pursuant to Section 3(a)(1) of the Bank Holding Company Act of 1956, as amended, defines "service area" as "that geographic area contiguous to an office from which approximately 80 percent of the dollar volume of that office's PC deposits is derived." The Fed recognizes that "market area" might be different from "service area" and where this is so, the bank is to note it and explain. One part of the application is a brief questionnaire on convenience and needs. (Exhibit D to the form). It currently contains very little information which would help the agency make the kinds of determinations that it will have to make under the CRA. The application for merger is more helpful (P.R. 70). It requires a catalogue of type and amount of loans made and inquiries into the "extent to which community needs for banking services are going unserved." Again, there is currently no special emphasis on the types of lending activity intended to be encouraged under the CRA.

The FDIC uses the concept of "trade area" and requires the applicant for a branch to "describe the trade territory which the proposed branch will-serve (include the geographic boundaries within which all or most of the proposed branch's potential customers reside) (FDIC form 6210/06 (10/73)). The form requests data on the population and the "number of housing starts" in the trade area." The application for a new bank is similar, but it contains a confidential section which calls for an estimate of "loan diversification" which can be directly related to CRA considerations (i.e. commercial, installment, real estate, term, purchased participation). In the FDIC merger application (Form 6220/01, 7-72) the corporation uses the concept of "service area" and defines it similarly to the Comptroller's definition of "primary service area." This form asks for a concise description of the service area, and whether it is residential, industrial etc. It asks about the "lending power and capacity" of the banks "in relation to the credit needs of its service area" and "how the lending power and capacity of the resulting bank will relate to those needs." The FDIC Manual of Examination Policies already warns examiners about attempts to manipulate trade areas to include segments of the community which might be helpful under traditional convenience and needs analysis. It will not be difficult to expand this warning to include gerrymandering to exclude low and moderate-income neighborhoods, where the lender may not wish to make loans.

The Federal Home Loan Bank Board uses the concept of "Savings Service Area" which is "that area from which the proposed institution expects to draw the majority of savings customers." (Appendix B to FHLBB Form 756, June 1971, Checklist of Supporting Documents For Permission to Organize). The Board explains:

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<sup>72</sup> CC Form 7021-01, the application for a change in location of head office or branch is also similar, CC Form 7027-Ola.

For the actual definition of the trade area it is necessary to use a number of broad indications of the supply and demand for savings activity.

The Bank Board approach, part of which can serve as a model for the other agencies, apparently inquires into the racial characteristics of the census tracts within the service area, as well as income levels, household income, type of occupancy and family size. It also inquires into "dilapidated, deteriorated and abandoned housing." The Board also requires a table showing the extent of racial segregation in the market and descriptions of sponsors of low and moderate income housing in the area. It is difficult to see how the banking agencies will be able to carry out the purposes of the CRA without comparable demographic data being solicited and available for analysis.

The Home Loan Bank Board recognizes that loan customers generally, are willing to travel further than savings customers, so that potential lending areas will probably be broader, not narrower., than the "savings service area." This is consistent with the CRA which, in final form, changed its emphasis from tying loan activity to the focus of deposit activity, and broadened it to the "entire community. Consequently, for purposes of the CRA, the "entire community" may be something other than the "trade area," "PSA," "Service Area" or "Savings Service Area" presently in use for determining the market area for deposit accounts. These definitions, however, are useful starting points.

As noted, this principle of identifying different geographic markets for different purposes is not new in banking law. The principle applies in defining the appropriate geographic market for assessing proposed bank mergers under the anti-trust laws. Thus in a district court opinion, *U.S. v. Provident National Bank*, 280 F. Supp. 1 (D.C. Pa. 1968), it was found that a distinction could be made between "wholesale accounts" which could be relegated to a "national market" and "retail accounts" which essentially are relegated to the "local community." In that case, the relevant market area for assessing the effect of a merger on competition was a four county area beyond which the Philadelphia banks could not establish branches and from which more than 80% of their deposits came.

Banking agencies have for several years been exercising common sense judgments about the approximate geographic market for assessing anti-competitive factors, and have been able to balance the many competing considerations involved. Depending on the banks being evaluated it may be a local, regional, statewide or national "community" or market. See *United States v. Crocker-An2lo National Bank*, 271 P. Supp. 133, 173 (N.D. Calif. 1967) ("The test as to whether any given geographic area is a relevant (economically significant) market or section of the country is not based on political boundaries but is based on economic grounds") (For some loans and activities, market is local, for others it can be national). See also *United States v. Phillipsburg National Bank*, 399 U.S. 350, 371, 372 (1969) ("The 'community to be served' is virtually always as large, or larger, than the geographic market") (Requires agency to assess impact on convenience and needs of entire relevant geographic market, not just part of it).

Although the considerations which go into defining a "community to be served" for merger purposes are somewhat different than for CRA purposes, the precedent exists for requiring a thoughtful and sensitive economic and sociological inquiry into the appropriate definition on a case by case basis. In most instances, the delineation of "community" will be relatively simply because of the de facto activities of the institution in the community (advertising, self-description of area by the lender, recruitment of employees, relationships with brokers and builders, pre-existing loan activity, source of deposits, location of pre-existing and proposed branches.) The principal role of "community" by lenders will be to assure that lenders do not attempt to evade

the impact of the CRA by unreasonably restricting the market initially, or by overlooking low and moderate income neighborhoods within their communities. Here, the agencies should probably promulgate an "equi-distance rule" which provides that if an institution is active in creating or serving potential markets which are X miles from its physical location, it must serve potential markets equi-distant from it, in all directions unless there is a significant reason why this cannot be done (e.g. small size of the institution, historical market areas observed in good faith, natural or political boundaries which make application of the rule impractical).

The large money-center banks, as a practical matter, are not different from other large lenders in major metropolitan areas. Given the purpose of CRA it is not unreasonable to assume that their "wholesale" loan activity, and such activities as foreign loans, correspondent bank relationships, secondary market operations, nation-wide loan participations, and investment and securities underwriting functions are probably not the kind of activities which were intended to define "community" under the CRA. A rule of reason would dictate that large banks of this kind should define "community" for CRA purposes in terms of the parameters of the metropolitan areas where they market their "retail" activities, seek deposits, are chartered, have their home offices and make most of their loans to individuals. (In New York City, this would include the city, its suburbs, including Connecticut and New Jersey, and for some banks, other communities where they maintain a physical presence). The CRA would impact these institutions most by imposing a legal obligation to meet credit needs in the low and moderate-income neighborhoods within this "community".<sup>73</sup> The important principal at work is that these massive institutions cannot legally ignore the low and moderate-income areas - and this is more than a salutary principal.

Some institutions, such as the large California savings and loans actually have an entire state as their "community," but the same approach to defining community for CRA purposes is appropriate. In the metropolitan areas where they are active, such as greater Los Angeles and the greater San Francisco Bay region, these large institutions engage in mass marketing using popular media. Accordingly, the entire SMSA of each city is appropriately their "community" and the obligation not to neglect low and moderate-income neighborhoods in these cities is called forth. For determining "community" for purposes of the isolated branches of these same institutions, or the branches located in smaller towns and cities, the criteria for smaller banks can be used. The concept of "community" is flexible enough to permit the use of different criteria for the same institutions in different geographic areas.

## **B. Determining Whether An Institution Is "Meeting Credit Needs"**

### **1. What Types Of Loans Are Involved**

Once the relevant community is defined, and the low and moderate-income areas in the community identified, it is necessary to establish criteria to help institutions know what is expected of them in their efforts to "meet credit needs" of the community.

It is axiomatic that an institution cannot be all things to all people - it cannot make every "good loan" of every type for which there may be a demand in the relevant market, nor can it service every segment of its market area equally - and the CRA does not compel an attempt to do so. There is legitimate diversity between

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<sup>73</sup> Some institutions present special cases. For instance, the aggressive management at Citibank may consider their retail market, at least for Bankcard purposes, to extend far beyond their New York base of operations. A question arises as to whether such an institution which actively solicits credit card customers in "outside" markets should be expected to make community development loans in "equi-distant" areas. To formally exempt them from doing so by Regulation, however, might encourage other lenders to abandon local lending for far-flung charge card type solicitations.

types of lenders and between particular lenders within a category and within a geographic area. Furthermore, the economic health of a community (which impacts on the economic health of adjoining communities) requires many types of credit services, so that such activities as the underwriting of municipal facilities directly or through the purchase of municipal bonds, loans to industry and business which help stimulate commerce, participation in the nationwide secondary markets are all activities which must go on and not be penalized CRA.<sup>74</sup> It is, however, a question of balance.

Under the CRA there are no fixed ratios of funds which must be diverted from the above uses and invested in housing and community development activities. However, the Act is intended to work by rewarding those with the best records and thus it creates a "natural" incentive system to become involved in housing-related urban lending. Accordingly, the regulators, agencies should not promulgate rules which look for some fixed percentage of loans of a certain type, but should articulate the types of activities which will be given priority when conducting CRA evaluations and allow "the market" to respond on a case by case basis. Lenders which choose not to alter their traditional patterns will find that the consequence of doing this is disapproval of their applications to branch, relocate, merge etc. Since CRA evaluations are directed at a lenders ongoing and historical record and its record for the entire community, rather than just its plans for the particular facility applied for, the lender's response to CRA will have to be more than transient or cosmetic. The legislative history indicates that the sponsors of the CRA believed that this type of pressure, which affects the lender's day-to-day ability to make changes in bank structure to take advantage of the market, would provide the most powerful incentive and would be most consistent with the operation of our mixed free enterprise economy.<sup>75</sup>

An additional encouragement would be provided by the examiners, who, as part of the regularly scheduled visitorial program, would be pointing out to management the lack of CRA activity, not necessarily for the purpose of imposing sanctions, but in order to remind them of the importance which will be attached to such activity in connection with agency evaluations of the institution's future applications.<sup>76</sup>

Given the legislative history of the CRA, it is not difficult to articulate the types of loans which should "count" in assessing a lender's record. They are loans directed toward housing and community development. This does not necessarily mean subsidized loans, for it is commonly agreed that the avail ability of funds for conventional individual mortgages from depository institutions is one of the most important barometers of a neighborhood's health (see e.g. the hearings on the Home Mortgage Disclosure Act). While different

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<sup>74</sup> Although Senator Proxmire continually criticized investment in loans to foreign governments in assailing the poor community lending records of some lenders (see e.g. q=.Rec., daily ed. June 6, 1977, at S.8958) it is fair to say that such activities do not characterize the lending patterns of most of the banks and associations affected by the CRA. A recent report on foreign lending activity indicated that although \$164.2 billion was outstanding in loans to foreigners, such loans were made by only 119 banks, having assets of \$1 billion or more. Although these banks represent more than half of the banking assets in the country, in terms of geographic coverage they are less than 1% of the more than 14,000 commercial banks, nationwide. See Country Exposure Lending Survey, Board of Governors of the Federal Reserve System, January 16, 1978. It should also be noted that Senator Proxmire, sponsor of the CRA was aware of the importance of maintaining a variety of lending services. See e.g. Hearings on 406 at 293. ("I agree also that this bill should not be designed to impede capital flow from capital surplus areas to capital deficit areas. We do not want to do that. That is not the intention of the bill. We should do all we can to prevent that effect.") This concession is significant because prior to World War II banking markets were generally localized, and expansion into "national markets" has been an important part of modern banking as well as post-war federal policy. (See 12 U.S.C. §1710 et seq. , FNMA and GNMA) ; 12 U.S.C. §1451-1459 (FHLMC). The CRA should not be read as intended to undo three decades of movement toward a liquid national mortgage market.

<sup>75</sup> See Statement of Senator Proxmire introducing S.406, Congressional Record, daily ed., January 24, 1977 at S.1202. It is also instructive to note the variety and volume of applications for structural change made on a continuing basis to the four regulatory agencies. See the "Agency Blotter" section of Washington Financial Reports, Bureau of National Affairs (BNA), Washington, D.C. (A weekly report on financial institutions).

<sup>76</sup> Particularly with the expected development of EFT and ATM facilities and convenience satellite deposit facilities, an institution cannot afford unnecessary impediments' in the application process, which would impair its ability to be competitive in the market. An examiner can appropriately point out to management the existence of such impediments.

neighborhoods will have different "needs" a representative list of "CRA loan activity" can be derived from the context of the Act and the record which preceded its passage, as discussed herein, supra. These might be divided into categories along the following lines, (which are not intended to be inclusive or exhaustive by any means):

a. Loans To Individuals

Home Mortgage Loans;  
Home Improvement Loans;  
Refinance and Rehabilitation Loans;  
Government - insured loans;

b. Housing Infra-structure Loans

Loans for multi-family development (including low and moderate income developments which are more than demonstration or experimental projects).

Participation in funding community development corporations.

Business and industrial loans which revitalize commerce in an area.

Municipal development loans for basic service facilities (i.e. sewers as opposed to stadiums).

c. Small Business Loans

Promulgation, by regulations published for comment, of a list of loan activities which the agency deems of the "community re-investment type"<sup>77</sup> is probably the most efficient and least obtrusive method of accomplishing the goals of the act, and will provide guidance to institutions desiring to improve their CRA record.

## 2. How Are "Credit Needs" To Be Met

Determining when an institution's activities (volume and mix of "CRA type" loans) are "sufficient" or "adequate" under the CRA is the most difficult task imposed on the agencies. Because of this, it would be misleading to suggest that regulations can be written which will reduce to an easy formula the criteria for compliance. We can, however, suggest a framework for approaching this determination.

The concept of "need" connotes "demand." Loans cannot be made unless there is a demand for them and a "need" is not unfulfilled if the demand does not exist.<sup>78</sup> Neither lenders, regulators nor their critics have been able to devise a workable litmus test for identifying and measuring the demand for various types of "CRA" loans in an area. The spectrum of choices range from "expressed demand" (applications received) to "potential demand," (the conceivable demand based on housing units, population and turnover in an area, requiring

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<sup>77</sup> This listing could be very roughly analogous to the Comptroller's Investment Securities Regulations, 12 CPR 1.1 - 1.431.

<sup>78</sup> The issue of "demand" has been at the core of the entire redlining controversy, with the industry insisting that demand does not exist (see editorial, Wall Street Journal, October 12, 1977) and critics of the industry asserting that the industry does not know how to measure demand. See also Mortgage Financing and Housing Markets in New York State; A Preliminary Report, presented to the New York State Legislature, May 10, 1977, Albany, by the New York State Banking Department. This report contains a classic example of the conflicting perspectives on the issue of demand.

analysis of land records and other indicators.) There are insurmountable difficulties with using either approach under the CRA. First, as to "expressed demand," there are too many variables which influence the lack of applications at a particular institution to make this a realistic measuring rod. One of these factors is the very effectiveness with which the institution may have discouraged applications from persons in certain areas in the past. Another is the perception, or image of the institution held by individuals in the community. (For instance, the fact that Morgan Guaranty Trust may not receive many applications for FRA, VA or 235 home loans, would not be a valid indicator that there is no "demand" for such loans in metropolitan New York) . The problem with the "potential demand" model is its complexity, speculativeness and the unreasonable burden which it would place on institutions and regulators. (Studies which seek to identify "potential demand" typically require sophisticated data collection techniques. The Home Loan Bank Board has recently commissioned a study, in three SMSAs, costing \$700,000.)

In reality, people have credit needs, not "neighborhood: per se, and it is neither particularly helpful nor practical to identify credit "needs" in the abstract and impose obligations on banks and savings associations to meet and satisfy a hypothetical measure of demand.

The most reasonable approach consistent with the CRA is that which we might call "identifying and reaching latent demand." This approach would recognize that there may be creditworthy individuals and organizations in the community (including low and moderate income neighborhoods) who have a credit need that can be met "consistent with the safe and sound operation" of the institution, but who may be unaware of the availability of funds or how to apply for them or who, under ordinary circumstances, may feel that submitting an application to a conventional depository institution would be a waste of effort. Reaching such individuals should be the highest priority under any CRA compliance program. If it can be determined that such individuals or organizations do not exist, despite a bona fide, good faith, affirmative attempt to reach them, then it might reasonably be concluded that there is no unmet credit need in the targeted community. The key to this approach is the effort to communicate with the community.

As Senator Proxmire noted at hearings on S.406 (at 2) . . . dozens of banks are either too lazy or too greedy to see the loan demand in their own communities. Demand in our economy is not a passive, fixed thing. It is manipulated and promoted. If a banker is willing to get out of the office he will find it. This bill would encourage him to do so.

During the hearings and during debate on S.406 Senator Proxmire repeatedly pointed to the actions of the South Shore Bank in Chicago as exemplifying "community re-investment lending" (See Hearings on 406 at 1, 2). In an exchange with the Chairman of South Shore Mr. Proxmire asked:<sup>79</sup>

-- We have heard a great deal from the trade associations about the lack of demand for mortgage credit in older neighborhoods. What is your experience in the South Shore area? Has demand materialized when you opened your doors and said you were available to make loans or did you have to go out and spread the word?

Mr. Grzywinski replied:

We did a lot of spreading the word. The first winter we were there the President of the bank and I thought we were running an independent political campaign

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<sup>79</sup> Hearings on 406 at 326.

because we spent two or three nights a week in parlor meetings, PTA meetings, telling people what we were trying to do with the bank.

... there is data which shows the notion of demand is really a myth. The realtors know where they can get loans . . . If he has a prospective buyer, he will send that buyer to the place where he is most certain he can get that loan . . . . People just have to know you are doing it.

In Philadelphia, the experience under the Philadelphia Mortgage plan indicates the existence of "latent" demand, for when the banks involved in that effort aggressively marketed their idea, they were able to make many hundreds of "safe and sound" mortgage loans in the "inner city." Chairman Proxmire referred to the Philadelphia approach as a "model" and as "an approach that would be commended to bankers under this bill."<sup>80</sup>

In California, extensive "anti-redlining" regulations of the savings and loan commission include affirmative marketing requirements. The industry has responded by "actively and eagerly" seeking out opportunities to make home loans and has undertaken "aggressive marketing efforts" in this regard.<sup>81</sup>

The results of the effort to expose "latent" demand were documented in an Affirmative Lending Update prepared by the California Savings and Loan League for the December, 1977 California Savings and Loan Journal.<sup>82</sup> Information from 32 savings associations described a variety of successful efforts to reach existing "demand" in areas traditionally regarded as "disinvested." The techniques used in California are easily transferable elsewhere.

The experience in these and other areas<sup>83</sup> suggests that the regulatory agencies should approach the issue of "meeting needs" by prescribing a series of steps aimed at identifying the actual demand and then evaluating the way that the demand, once identified, is handled. An institution's program for accomplishing these goals might have the following framework.

- a. Identify the institution's market area.
- b. Identify the low and moderate-income neighborhoods in the area.<sup>84</sup>
- c. Determine the types of loans which are going to be made available in a particular time frame.<sup>85</sup> (asset management) (This determination will change from time to time, as market conditions change.)

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<sup>80</sup> Congressional Record, daily ed., June 6, 1977 at S.8959.

<sup>81</sup> Interview with Gordon Luce, President, California savings and Loan League, reprinted in "Voice News and Viewpoint," periodical, Wednesday November 9, 1977.

<sup>82</sup> References are to material conveyed to author by 1-7. Dean Cannon Jr., Executive Vice President, California League, by letter dated November 30, 1977. (On file with author.)

<sup>83</sup> See e.g. Bankers and Community involvement, American Bankers Association, Washington, D.C. 1978.

<sup>84</sup> It should be self-evident that an institution cannot treat all neighborhoods in its market area the same and even some neighborhoods in the same socio-economic stratum will have more funds invested in it than others under the above approach. This is true because the marketing campaign (which is the basic tool identifying demand), will probably generate demand unevenly from area to area. However, by letting the market itself define demand, neither the institution nor the regulator has to impose artificial criteria on "meeting credit needs."

<sup>85</sup> Many commercial banks have historically not been active in the mortgage market and regulators have generally taken the position that each institution should decide for itself whether to make mortgage loans. While the CRA does not change this, it does reasonably seem to make mortgage lending one factor to be considered, so that all things being equal, an institution with a good, balanced mortgage lending record would be assessed more highly than one which chose not to meet the demand for mortgages in its community. Not to adopt this approach would seem to destroy the thrust of the CRA. It should be noted, however, that a lack of

- d. Devise an effective, comprehensive affirmative marketing plan to communicate the availability of loans to the entire market area. (The strategy in some neighborhoods may be different than in others. Language differences may also have to be taken into account. The marketing plan should not be restricted to use of popular media, but must also include contacts in the community and among real estate agents in the community.) It should be noted that the language of §802 of the CRA speaks of a "continuing and affirmative obligation to help meet" credit needs. This raises the irresistible inference that the obligation is not a passive one and actually requires some positive action in order to be fulfilled.<sup>86</sup>
- e. Devise a program to obtain opinions from within the community as to the type of credit services which are needed. It is impossible to "meet community needs" if an institution is not in touch with the community involved. This is particularly so when the management does not reside in the communities affected one of the major thrusts behind the CRA is to break down the barriers between community organizations and lenders who may presume to understand an area's needs without consulting a broad spectrum of opinion in the community. By letting the community help define its needs for the lending industry and by letting demand be shaped by the natural flow of applications in response to affirmative marketing, institutions and agencies obviate the need to devise arbitrary rules for meeting needs.
- f. Review all underwriting criteria to assure that risk assessment techniques are reasonably accurate.<sup>87</sup> This includes appraisal and property underwriting criteria.
- g. Review all "flow of application" procedures to remove unnecessary barriers to loans in low and moderate income neighborhoods (e.g. assure the availability of applications at all branches, remove unreasonable application fees, review policy of refusing to make PMI loans or government insured loans, assure that applications are considered individually and not "prescreened," remove any restrictions on accepting applications from particular areas.)
- h. Review all procedures and employee practices for Fair Housing and ECOA compliance and establish a continuing monitoring program in this regard.

The above is a skeleton of a proposed "first phase" program. The most important consideration is the Bottom-line - the loans which are made. However, if a lender is operating in good faith in identifying community need, successful loan performance should logically follow. In promulgating CRA regulations, the agencies might be well advised to prescribe the effort expected to be made rather than any particular level of performance anticipated, particularly at this early stage of CRA enforcement. Performance can then be judged on a case-by-case basis, against the backdrop of the record of an institution's effort.<sup>88</sup>

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mortgage loans might reasonably be offset by substantial lending which improves the "housing infra-structure," or municipal services, or small business needs. Failure to be active in any regard in community lending would count heavily against an institution.

<sup>86</sup> Institutions with modest advertising budgets need not take on expensive additional advertising, but might redirect their advertising to be more effective. For instance, some institutions advertise for mortgage loans in the financial pages of newspapers. This is probably wasted, in terms of meeting CRA criteria. Institutions with little or no advertising programs, who rely on their "image" in the community may find that this "image," in reality, works against them, and that some outreach effort is needed in order to meet CRA evaluations, at least until the image in the community is improved.

<sup>87</sup> An entire literature is being generated on this subject. See Settlement Agreement, United States v. American Institute of Real Estate Appraisers, (76-C-1448) (N.D. Illinois); under writing Guidelines, Federal Home Loan Mortgage Corporation; Proposed Non-discrimination Regulations, Federal Home Loan Bank Board. (Proposed amendments to 12 CFR Part 528, November 14, 1977.)

<sup>88</sup> One public-interest organization has made a set of innovative proposals to the Comptroller designed to increase community participation in the lending process. The Woodstock Institute suggests that lenders could benefit by having "community advisory

### 3. "Assessing" The Record

The regulations to be promulgated under the CRA will presumably be designed to provide guidance to lenders as to what is expected of them under the Act. It is also necessary, however, at the outset to provide examiners and supervisory agency staff with a program of direction in going about the process of assessment of a lender's record.<sup>89</sup>

The first almost elementary aspect of any assessment should be an evaluation of the lenders record under the Fair Housing Act, Equal Credit Opportunity Act and related non-discrimination regulations. A lender in violation of these provisions is, a priori, not meeting the needs of his community.<sup>90</sup> With the exception of the Home Loan Bank Board, the regulatory agencies have not yet made a major effort to teach examiners the basics of civil rights law and the historical reasons for enforcing such laws.<sup>91</sup> Without such an understanding civil rights law enforcement is generally ineffective.<sup>92</sup> Settlement of the lawsuit against them for non-enforcement of the Fair Housing Act is expected to change this somewhat for the settling agencies,<sup>93</sup> although the Federal Reserve Board continue to contest it's obligations under the Fair Housing Act.

Techniques have already been developed for sampling and comparing accepted and rejected loan files, lender forms and policies, to test for discrimination. These should be institutionalized in examiner training, so that the examiner's report on civil rights compliance is more than pro-forma.

There are also appropriate models for dealing comprehensively with discrimination in finance through regulation. (The California Regulations, together with their guidelines, provide an excellent model. See the Hearings on S.406 at 223-224).

Examiners should be given a program for, analyzing Home Mortgage Disclosure Act data as an integral part of the CRA review. Loan locations should be plotted on race and income coded census tract maps, with overlays for the different types of loans on the report. This device gives the examiner a tool for reviewing the institution's designation of "market area" and spotting "gerrymandered" neighborhoods. If mortgage loan activity is generally low, or low in particular areas, the HMDA data will reveal this and provide an opportunity for the examiner to ask management why this is so. This will generally lead to a review of the institutions

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boards" for the home office and branches. They suggest "modest funding" for these boards to research the credit needs of the communities and assess the institution's record. (Presumably such Boards could be constituted without an improper delegation of authority from the Board of Directors). Such Boards might even be a useful aid in identifying properties and loans which are good risks, and separating them from less prudent risks. An institution with the community "on its side" would occupy a better position in its market, generally, and might gain a competitive advantage in some areas. See Memorandum of Lawrence B. Rosser, Executive Director, Woodstock Institute, presented to Comptroller of the Currency, August 5, 1977, (copy in author's files). Another commentator has suggested that the Community Re-investment Act should provide an impetus to involve lenders in the Community Block Grant Program and suggests that the act might require familiarity with the local jurisdiction's community development plan, housing assistance plan and citizen participation plan. See, Steven M. Rohde, Implementation of the Community Re-investment Act, paper submitted to URP, October 1977. While such activity would be highly commendable under the CRA, it might also be too ambitious at this stage to suggest that such involvement be required. (Note that Chairman Robert H. McKinney of the Federal Home Loan Bank Board has recently proposed a three-pronged approach to urban lending which includes authorization for thrift institutions to invest in urban communities participating in Federal grant programs. (Remarks at meeting of United States Conference of Mayors, January 26, 1978, as reported in the American Banker, January 27th, 1978, Page 1.)

<sup>89</sup> Because of the somewhat ambiguous nature of the text of the CRI examiners, at a minimum, should be exposed to the legislative history of the Act and given substantive background on the problems of "urban disinvestment" with which they now must deal.

<sup>90</sup> See Testimony of Garth Marston on behalf of Home Loan Bank Board Hearings on S.406 at 243.

<sup>91</sup> Second Report on Enforcement of the equal Credit Opportunity and Home Mortgage Disclosure Acts, Committee on Banking, Housing and Urban Affairs, United States-Senate, 95th Cong., 1st Session, March 1977.

<sup>92</sup> See Dennis, Guidelines for Non-discrimination In Lending; Federal Home Loan Bank Board Handbook For Examiners (1977).

<sup>93</sup> Urban League et al. v. Comptroller of the Currency, C.A. No. 76-0718 (D.C. D.C.) (filed April 26, 1976).

outreach and affirmative marketing program and procedures for accepting and processing applications. This will lead to an opportunity to catch "prescreening" and unreasonably restrictive practices, such as failure to provide adequate information on application procedures in some areas, unduly burdensome application requirements, and similar practices inconsistent with the CRA.

Under Regulation B of the Equal Credit Opportunity Act<sup>94</sup> an institution is required to maintain accepted and rejected applications. Provided that prescreening is controlled,<sup>95</sup> this regulation generates sufficient data to enable the examiner to profile the characteristics of persons who apply for loans (including their location and the type of loan applied for) and to compare this with a profile of the type of persons who have actually obtained loans (or been rejected). This analysis provides an occasion for the examiner to again review the institution's outreach effort to determine why it is not more effective in certain areas, if that is the case. If the outreach effort is substantial and in good faith and it still results in few applications (or few qualified applications) then the institution would not be given a poor CRA performance rating, even though actual "CRA type" loans made were few. On the other hand, a poor lending performance might trigger valid criticisms of the institution's marketing and image approach, which would then lead to (a) noting of this fact on the examination report and (b) obtaining of a commitment to better performance in the future. When examining in connection with a particular application for structural change, (as opposed to the regularly scheduled examination) the examiner will have the benefit of the application and its exhibits to assist in the evaluation. As noted earlier, the various applications currently in use can, with relatively minor adaptations, be made very helpful in making "CRA" evaluations.

A review of the examination manuals of the four regulatory agencies indicates that rarely is an instruction given for the examiner to it gather information. (The FHLBB sanctions this in connection with some discrimination investigations.) For CRA Purposes, it may be necessary for examiners to meet with or interview community organizations, minority brokers and others with information about the institutions corporate attitude toward the community. In view of their training as financial specialists, examiners may be reluctant to take on this task, and there may also be a mutual credibility gap between the examiner and community groups. Since a fair "assessment" under the CRA may not be possible without this kind of inquiry, examiners should be given the necessary training to deal effectively in the role of the public representative of the government when dealing with community groups, or, alternatively special examiners should be hired and trained for this purpose.<sup>96</sup>

#### **4. Procedure For "Taking The Record Into Account"**

In crafting this aspect of their regulations, the supervisory agencies have a special opportunity to either effectuate or disregard the basic spirit of the Community Reinvestment Act. Their opportunities are really twofold, for this aspect of the CRA requires the agencies to (a) develop a policy governing their intended substantive approach to making determinations under the act and (b) design procedural mechanisms for handling applications, protests, hearings and investigations in connection with the CRA.

##### **a. Substantive Considerations**

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<sup>94</sup> 12 CFR §202.

<sup>95</sup> Prescreening is the practice of informally discouraging applicants and serious inquirers without providing an adverse action notice or otherwise making a written record of the contact, thus making regulatory review impossible. Proper interpretation of Regulation B by the federal agencies can control this. For further analysis in this regard see Comments of the Pennsylvania Savings League to the Proposed Non-discrimination Regulations of the Federal Home Loan Bank Board, December, 1977, on file with the Board and with the author.

<sup>96</sup> The Woodstock Institute has suggested that the examination process include "preannounce public meeting, in the bank, during the evening hours." Rohde has proposed making segments of examination reports available to the public.

As to substantive considerations, it is recommended that each agency issue a policy statement covering their view of the weight to be given to CRA factors in the various determinations which they will be called on to make under Section 803. The agencies can approach this task grudgingly and narrowly, or with a balanced regard for the broad purposes and important policy behind the act. There are at least two models available for the way not to proceed. By analyzing these two cases, identify the kinds of substantive decisional we can 1 policies which can reasonably be said to frustrate the CRA and conversely, be instructed in positive alternative ways to view CRA evaluations. The instances in point involve decisions made by the Federal Reserve Board. At issue is not so much the result arrived at, but the method of getting there, in which the Fed displayed what might be viewed as an insular, arrogant, almost hostile attitude toward the goals of community-based protestors, as well as a surprising lack of basic knowledge about rules of construction under civil rights laws. The Community Re-investment Act, if it augers any change at all, should hopefully lead to changes in the approach evidenced in these two examples.

In the matter of Marine Midland Banks Inc., of Buffalo, New York, a bank holding company applied under section 3(a)(3) of the Bank Holding Company Act (12 U.S.C. 1842(a)(3)) to acquire 100 percent of the voting stock of a proposed new bank.<sup>97</sup> This move was antecedent to a proposed merger of all the Bolding Company's banks into one bank, taking advantage of then impending changes in New York State banking law which would permit statewide branching. The bank was the 7th largest bank in the state, controlling 6% of the total commercial bank deposits in the State of New York.

The Public Interest Research Group (PIRG) filed a protest under Board procedures. PIRG alleged that certain studies compiled by citizen groups showed that the bank had not made significant numbers of mortgage loans in their county and that by consolidating, the various banks would lose local boards of directors and thus would be less responsive to local needs. PIRG requested the Fed to explore these issues by acquiring additional information about the bank's lending practices and to condition approval of the application on obtaining certain commitments from the applicant.

The Board rejected the PIRG argument on grounds that would appear wholly inappropriate under the CRA, and which typify, perhaps, the kind of attitude which called such legislation into being.

First, the Board rejected the contention that there might be some obligation to meet mortgage credit needs ("Focus on one particular service does not give a meaningful picture of a bank's overall service to the community....."). This conclusion was reached, apparently, without actually considering the impact of Midland's lending policies on the community to see if, in this instance, the bank's activities were consistent with overall community credit and housing needs. There seemed to be a "presumption of correctness" in operation. (Naturally the CRA does not provide or suggest that we are capable of creating a calculus of social priorities which would permit regulators to mathematically compute the relative value of one method of meeting credit heeds as compared to the possible alternatives. However, the Act probably does require a "sensitive inquiry" into the impact of alternative approaches, with the good faith exercise of judgment being incumbent upon the agency.)

Second, the Board rejected the contention that it had any responsibility for "such matters as discriminatory lending practices." It said that these were the responsibilities of "other agencies of government" and it asserted that "there are constraints upon the extent to which such laws as the Bank Holding Company and Bank Merger Acts should appropriately be used to achieve favored social objectives."<sup>98</sup>

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<sup>97</sup> Federal Reserve Bulletin, December 1975 at 890.

<sup>98</sup> Quite remarkably, the Fed did not discern that allegations of discrimination arc matters of legal as well as "social" obligation, under laws for which the Fed is given enforcement responsibility.

Third, the Board interpreted the very request that it undertake an independent investigation as "recognition" by PIRG that its own data was insufficient. This represents a very unusual principle of administrative law.

Fourth, the Board asserted that it could not undertake such an independent investigation in view of the fact that it must consider many hundreds of bank holding company applications each year, making its obligations under the law contingent upon administrative convenience.

Fifth, the Board, while acknowledging that the applicant bank had the legal burden of establishing that it has satisfied the statutory criteria, asserted, without legal citation, that the filing of a protest shifts the burden to the protestor and away from the applicant.

Sixth, the Board overtly rejected the contention that "a bank should meet the credit needs of the local community before it engages in any large scale transfer of funds to other areas."

Seventh, the Board concluded that convenience and needs of the community would be served by the proposal because, *inter alia*

the quality of banking services generally would be improved by "efficiency of operation" and "utilization of centralized management expertise."

the bank would have a greater lending limit (to make larger commercial loans).

accounts receivable and inventory financing would be improved.

the issuance of credit cards would be simplified.

trust services would be enhanced.

The Fed did not include in its balancing equation the impact on community housing and development credit needs, and found, impliedly, that this was outside the concept of convenience and needs.

Most disturbing among the conclusions reached by the Fed is that regarding the Fed's opinion of what constitutes legal evidence of discrimination. The Board reviewed the data marshaled by PIRG, consisting of statistical analyses of loan patterns and concluded that the patterns do not show "disinvestment."

After rejecting the merits of the disinvestment claim<sup>99</sup> the Board added the gratuitous observation that statistical data of the type gathered "should not be relied upon as a basis for conclusions of the sort urged by PIRG . . . . The Board cannot infer discrimination simply from data relating to differing volumes of mortgage credit in different area." This result ignores a rich judicial literature describing the effect of statistical showings in cases of discrimination. It disregards the well-established concept of the "prima facie case" and the uncontroversial principal that statistics can often be relied upon to "infer discrimination," both as a rule of evidence and of law. Reviewing only cases decided at the time of the Fed's decision, there is no want of precedent in this regard. See the employment and housing cases cited in *Williams v. Mathews*, 499 F.2d 819 (8th Cir. 1974) cert. den. 419 U.S. 1027 (1974) (Housing); and *U.S. v. Real Estate Development Corp.*, 347 F. Supp. 776 (N.D. Miss. 1972) (Housing). It is hornbook civil rights law that "statistics often tell much and courts listen." *State of Alabama v. United States*, 304 F.2d 583 (5th Cir. 1962) aff'd 371 U.S. 37 (1962). (Recent

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<sup>99</sup>The validity of the Fed's conclusion on the merits with respect to the particular facts at hand, is not questioned here.

decisions of the Supreme Court have of course, affirmed this principal. See e.g. *Dothard v. Rawlinson* U.S. 97 Sup. Ct. 2720 (1977) and *International Brotherhood of Teamsters v. United States*, 431 U.S. 324, 334 (1977).

Another decision of the Fed also involved a challenge by a PIRG organization. In the matter of *American Security Corporation*, Washington, D.C.,<sup>100</sup> the Board also rejected the PIRG challenge. In that case, a bank holding company applied for permission to acquire shares in what was essentially a reorganization of an existing corporate relationship, with no new bank assets or expansion involved. The Board, (without difficulty) determined the "relevant market" of the underlying bank to be the District of Columbia and its surrounding suburban counties (the SMSA). The bank represents 25% of the commercial bank deposits in D.C. and 11% in the "relevant market." All of its offices were in the District. In this case-there were significant managerial and financial considerations which appeared to work in favor of the application and it might be, on balance, that these should have outweighed other factors, including community convenience and needs. However, the approach taken by the Board to the convenience and needs factor indicates that it was not regarded as having any particular priority at all in the Fed's evaluations.

The PIRG protest centered on alleged employment discrimination (which we will not consider here) and an alleged failure of the D.C. bank to (a) make residential 1-4 mortgage loans (b) make FHA and VA loans and (c) make small business loans. The Fed, relying on its decision in the *Marine Midland* case, pointed out that such loans represent only two types of services among the fifteen banking services offered and "it would not be appropriate to assess AT&T's performance in satisfying the convenience and needs of the community by focusing on only two of the many services it offers . . . Moreover, commercial banks have not traditionally been primary lenders in the residential mortgage market." The Board then cited figures to show that over the years the bank had traditionally neglected the local mortgage market and used these very figures to justify its continuing to do so. The Board indicated it had to discount the PIRG claims "unless it were to be argued that AT&T has an obligation to increase its total residential mortgage lending" and found that there is nothing in the law that compels such a conclusion.

The Board did cite and balance the fact that the bank was one of the only sources for other types of loans needed in the local economy, and that it made loans that might be characterized as supportive of the "housing infrastructure" (e.g. multi-family construction, offices, hotels, loans to savings and loans and mortgage bankers). Accordingly, it might be that, even under new standards, the application should not have been disapproved. However, if a similar case were to arise under current standards, the correct legal standard of evaluation would have to be different from the one utilized by the Board in the AT&T matter. The CRA requires attention to the needs of the "entire community" including "low and moderate income neighborhoods" and no part of the Fed evaluation touched on an inquiry into the Bank's efforts to reach such areas. While indirect support of the housing infrastructure is not unimportant, it can be argued that the CRA does require more direct involvement in housing credit needs. Particularly where the second largest bank in a city and the third largest in the relevant market area makes only 5.8% of the residential loans in the city, a circumstance is created which the CRA fits like a glove. It would appear that under the CRA, given the same fact pattern, a commitment to greater efforts to make direct loans to the community would have been appropriate or alternatively, demonstration of a substantial reason for not doing so should have been made.

The Board's analysis of the racial discrimination allegation in the AT&T and is also problematic. Rather than calling for an examination to explore actual lending policy, application flow and underwriting decisions, the Board relied on a series of "inferences" and speculations to explain away statistical showings, in favor of the lender. By adopting a policy hypothesizing "possible" explanations not necessarily documented in the record, the Board makes the burden of proof on protestors virtually insurmountable. In this case the record showed that

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<sup>100</sup> Federal Reserve Bulletin, March 1976, at 256.

of the few millions of dollars of mortgage loans which were made, the vast majority were made in three predominantly white areas with 17%, of the city's population - while a very few were made in 16 mixed or black areas with 83% of the population. In 7 of these areas there were no loans. Also, there were no FHA and VA loans, although of such loans made in the District by others, 85% of the borrowers were black. Also, only \$28,000 was originated under the Small Business Administration program while 7000 of the black owned businesses in the District are "small businesses." The Board found these statistics to be "inconclusive." Quite remarkably the Board cited as a defense to these statistics the "possibility" that most of the applicants to the bank were white. Rather than being a defense, this factor in itself may call into question a bank's image, marketing and prescreening policies, in a city which is occupied principally by non-whites.

The Board also considered only whether there was "intentional discrimination" and omitted all references to the "effects test" which was a well established principal in civil rights law at the time<sup>101</sup>, and is now incorporated into the Fed's own Regulation B. Another interesting feature of this opinion is the Board's reliance, for defense purposes, on statistics produced under a Home Loan Bank Board pilot project study which the Board claimed was evidential of loans being made to blacks. The same study showed, in a number of cases, nationwide, that certain banks had very poor statistical records of lending to minorities, but the study was not used as the basis of a single enforcement action by the red against any lender because the figures were generally regarded as being "inconclusive."

Finally, the Board found that convenience and needs "carried little weight" in this application for reorganization because the proposed change did not involve a change in service to the market. (Note that, under the CRA, such applications are not differentiated as less important than others, from a community convenience and needs point of view. In fact, to approach it in this way removes part of the reward/incentive aspect of the CRA structure, which ties applications to the lender's ongoing record, not just to the effects of the proposed change.)

Even assuming a more positive substantive attitude on the part of the agencies in the future than that exhibited by the Fed in the two examples cited, above, there remain many difficult questions in applying the CPA. For instance, in evaluating a lender's record, should the agency judge the record in comparison with the records of other lenders or against some fixed abstract standard? If an applicant is judged against other applicants, would not a "competition in laxity" result? Where a lender has a presence in an entire SMSA, and various low and moderate-income neighborhoods compete for loans, how will a lender's record be assessed if some areas are more successfully treated than others?

These and other questions of substantive policy cannot be decided in a vacuum, and will have to await case-by-case consideration.<sup>102</sup>

## **b. Procedural Considerations**

Each agency currently has regulations governing protest, comment, notice and hearing procedures in connection with the applications covered by Section 803. Each of these, however, is geared toward a sophisticated and specialized audience, made up principally of competing institutions, and their lawyers who are used to dealing with technical, legalistic criteria. Arguably the CRA is intended to open the process to a lay

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<sup>101</sup> See e.g. *Griggs v. Duke Power Co.*, 401 U.S. 424 (1971).

<sup>102</sup> Although regulations do not have to be promulgated until 390 days after October 12, 1977, it would appear that the act itself went into effect immediately upon execution. The rules of statutory interpretation provide that unless expressly indicated to the contrary, laws take effect immediately. See *Arnold v. U.S.*, 13 U.S. 103, 119 (1815); *U.S. v. Clizer*, 464 F.2d 121, 12:F(1972). In other recent laws which Congress intended to delay, the delay was expressly set forth. E.g., Home Mortgage Disclosure Act, Consumer Leasing Act of 1976.

audience of interested, community groups and public interest organizations. To accommodate this new source of interested and potentially aggrieved persons, the agencies may have to revise their procedures.

In the original version of the Act, it was provided that the agency programs would include:

- (3) permitting and encouraging community, consumer or similar organizations to present testimony at hearings on applications for deposit facilities on how well the applicant has met or is proposing to meet the credit needs of the community served or to be served by the applicant or its subsidiaries.

This section was deleted from the final bill, and there is no explicit creation of standing for such organizations.<sup>103</sup> However, the general rules of the agencies are broad enough to permit participation by community groups. For instance, in September 1977 the FDIC published new rules for considering applications (12 CFR 303.14).<sup>104</sup> These require publication of notice of the applications, with a specific notice of the public's right to comment. Unfortunately, these regulations do not require that publication be in the general sections of the newspapers, or in community papers, so lenders can continue to publish in the "legal notices" sections of classified ads. The time limit for filing public comments is also relatively short. The regulations do provide for public access to the convenience and needs section of the investigation report, which is helpful. One potentially innovative provision permits the regional director to solicit comments from any persons whom he believes may have a special interest. This provision might be used to regularize special notice to a variety of community sources by the agency, when applications are filed by lenders.

The Comptroller's regulations are somewhat similar and subject to the same comments (12 CFR 55). Not unexpectedly, the Fed's Rules of Procedure are the least consumer oriented. (12 CFR §262.3)

Each of the agencies has traditionally operated in a decentralized manner with respect to applications for structural change, either through regional supervisors or through the regional Home Loan and regional Federal Reserve Banks. The Courts have approved such delegations and provide the agencies with a good deal of flexibility in setting up their procedures. (See e.g. *Guaranty Savings and Loan Association v. FHLBB*, 330 F. Supp. 470 (D.C. 1971).) However, there are sometimes differences in procedures between regional offices, and for CRA purposes, national policy should be uniform, insofar as is possible. This should be reflected as a matter of policy, in agency wide procedures.

The agencies are generally not required under their operating statutes or the Administrative Procedures Act to hold hearings or make formal findings in connection with consideration of applications for changes in structure. (See *Camp v. Pitts*, 411 U.S. 133, 140 (1973) (Application for National Bank Charter).<sup>105</sup> See also *Benton Savings and Loan Association v. Federal Home Loan Bank Board*, 365 F. Supp. 1103 (D.C. Ark. 1973) This, together with deletion from the CRA of the requirement that community groups be given hearing opportunities, generally provides the agencies with broad discretion in establishing procedural rules for evaluating performance. It can be anticipated, however, that when fully implemented, the CRA will generate substantial protest and comment activity from groups around the country because, for the first time, it provides

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<sup>103</sup> Community Residents would appear to be "aggrieved persons" generally. See e.g. 12 U.S.C. 1849 (judicial Review, Bank Holding Company) and 12 U.S.C. 1730a(k). (judicial Review, Savings and Loan Holding Companies.)

<sup>104</sup> See also 12 CFR 545.14g (Savings and Loan Branch office procedures). Note that there is some question as to whether the Bank Board considers the protests of community groups to be "substantial" under their rules. See Motion For Experiment of Biased Findings and Recommendations, etc. In the Matter of the Application of Perpetual Federal Savings and Loan Application to Establish a Branch, before the Federal Home Loan Bank, Board, 2/412/77, by Adams Morgan organization (on file with FHLBB and with author).

<sup>105</sup> There are exceptions. See e.g. 94 of the Bank Holding Company Act.

a legal lever for expressing their concerns. Regulations to effectuate the "purposes" of the CRA, as mandated in Section 806, should reasonably attempt to open up the decision-making process to receive the viewpoints of community groups, and accommodate their limited ability to participate on the same scale as lenders.

## VII. MODELS FOR FEDERAL REGULATORS

In confronting problems of redlining and community re-investment, many states are ahead of the federal government. Actions taken or soon to be taken in New York, Massachusetts, Connecticut, Illinois and California reflect innovative governmental response to difficult problems, which are available as guidance for federal regulators.<sup>106</sup> Among the many approaches worth examining are the requirements in New York that institutions provide mortgage applications in all offices (Chapter 205, New York Banking Law, Section 6-C., Effective June 1, 1977<sup>107</sup>) and the requirements in California that proposed relocations be analyzed in a Neighborhood Impact Statement. The so-called "California Approach" contains some thought-through solutions to many of the problems confronting federal agencies under the CRA. (Although some of the California standards may be difficult to apply in practice, the general guidelines and discussion of the effects test and of appraisal standards are quite helpful.)

In Maine, a provision of the state code (9.B MRSA §255) permits 25 or more citizens to require the bank regulator to conduct a hearing on whether an institution is serving the community.

The Massachusetts approach is described by Commissioner Greenwald at p. 167 of the Hearings on S.406. Significantly Chairman Proxmire commented that Massachusetts has "done a lot of what we have in mind in this bill administratively under (its) general public interest authority" (Hearings on S.406 at 226). Massachusetts, as of this writing, is planning a broader set of recommendations to deal with redlining which will rival the California regulations for their comprehensiveness.

Characterizing part of the problem and the California response to it one writer has observed:<sup>108</sup>

Urban lending institutions often relocate themselves out of declining areas by establishing a branch office in a suburban community and subsequently phasing out of the original facility. The result is frequently to leave the urban neighborhood without a source of mortgage funds. At present, there is little to prevent lending institutions from engaging in this practice. A bank contemplating relocation will not consider the impact of its move upon the neighborhood that it was chartered to serve; federal and state regulation of institutional relocation merely requires the bank to establish a need for its services in the neighborhood to which it desires to move. Thus, regardless of the effect on the urban neighborhood, if the need for a new office in the suburban community can be demonstrated, branching is allowed.

. . . California has recognized (this problem) and has responded with new banking regulations. Any change of location by a lending institution now requires a

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<sup>106</sup> A partial review of state redlining initiatives appears at p. 183 of the Hearings on S.406. A more in-depth analysis of state laws is contained in an excellent unpublished paper prepared for the President's Urban and Regional Policy Task Force on Redlining, by Professor Andrew Gold of Trinity College. (on file with author)

<sup>107</sup> The New York Superintendent of Banks is considering a comprehensive community re-investment proposal and has held public hearings on it. See *American Banker*, January 27, 1978, page 1.

<sup>108</sup> Baptiste; *Attacking the Urban Redlining Problem*, 56 B.U. Law Review, 989, 1013-1014, November, 1976.

showing that 'the area served by the original location will continue to be adequately served after the change of location is effective! To further safeguard the original community's interest, the California revision requires institutions both to give public notice of a contemplated change of location and to submit to a public hearings on the continued availability of mortgage funds in the community after the contemplated move. This is the kind of action that is necessary to prevent the arbitrary and destructive closing of urban home offices.

## **VIII. CONCLUSION**

The only section of the Community Re-investment Act not yet discussed is Section 805. This provides that:

Each appropriate Federal financial supervisory agency shall include in its annual report to the Congress a section outlining the actions it has taken to carry out its responsibility under this title.

If past experience is a guide, it would not be unexpected for the Senate Committee on Banking to hold oversight hearings on implementation of the CRA within a reasonable time after the agencies act. Hopefully, the record of these hearings will reflect a conscientious and successful effort to carry out the spirit as well as the letter of the Act, and bring about a substantial contribution from the private sector to the neighborhood revitalization effort.

### **APPENDIX A-1**

05<sup>th</sup> CONGRESS  
1<sup>st</sup> Session S.406

#### **IN THE SENATE OF THE UNITED STATES**

JANUARY 21 (legislative day, January 19), 1977 - Mr. Pitoxmire introduced the following bill; which was read twice and referred to the Committee on Banking, Housing and Urban Affairs.

#### **A BILL**

To encourage financial institutions to help meet the credit need of the communities in which they are chartered, and for other purposes.

1. Be it enacted by the Senate and House of Representatives
2. of the United States of American in Congress assembled,
3. **SHORT TITLE**
4. **SECTION 1.** This Act may lie cited its the "Community
5. Reinvestment Act of 1977".
6. **FINDINGS AND PURPOSE**
7. **SEC. 2. (n)** The Congress finds that-
8. (1) regulated financial institutions are required by
9. law to demonstrate that their deposit facilities serve the
10. convenience and needs of the communities in which
11. they are chartered to do business;
12. (2) the convenience and needs of communities includes

13. the need for credit services as well, as deposit  
14. services; and  
15. (3) regulated financial institutions have continuing  
16. and affirmative obligation to help) meet the credit needs  
17. of the local communities in which they are chartered.  
18. (b) It is the purpose of this Act to require each appropriate  
19. Federal financial supervisory agency to use its authority  
20. when chartering, examining, supervising, and regulating  
21. financial institutions, to encourage such institutions to  
22. help meet the credit needs of the local communities in which  
23. they are chartered consistent with the safe and sound  
24. operation of such institutions.

25. DEFINITIONS

26. Sec. 3. For the purposes of this Act-

27. (1) the term "appropriate Federal financial supervisory  
28. agency" means –

29. (A) the Comptroller of the Currency with,  
30. respect to national banks;

31. (B) the Board of Governors of the Federal  
32. Reserve System with respect to State chartered  
33. banks which are members of the Federal Reserve  
34. System and bank holding companies;

35. (C) the Federal Deposit Insurance Corporation  
36. with respect to State chartered banks and savings  
37. banks which are not members of the Federal  
38. Reserve System and the deposits of which are  
39. insured by the Corporation; and

40. (D) the Federal Home Loan Bank Board with  
41. respect to institutions the deposits of which are insured  
42. by the Federal Savings and Loan Insurance  
43. Corporation and to savings and loan holding companies;

44. (2) the term "regulated financial institution"  
45. means an insured bank as defined in section 3 of the  
46. Federal Deposit Insurance Act or an insured institution  
47. as defined in section 401 of the -National Housing. Act;

48. (3) the term "application for a deposit facility"  
49. means an application to the appropriate Federal financial  
50. supervisory agency otherwise required under Federal  
51. law or regulations there under for –

52. (A) a charter for a national bank or Federal  
53. savings and loan association;

54. (B) deposit insurance in connection with a  
55. newly chartered State bank, savings) banks, savings  
56. and loan association or similar institution;

57. (C) the establishment of at branch or other  
58. facility with tile ability to accept deposits of a  
59. regulated financial institution;

60. (D) the relocation of the home office or a  
61. branch office of a regulated financial institution;

62. (E) the merger or consolidation with, or the  
63. acquisition of tile assets, or the assumption of the  
64. liabilities of a regulated financial institution requiring  
65. approval under section 18(c) of the Federal  
66. Deposit Insurance Act or under regulations issued  
67. under the authority of title IV of the National  
68. Housing Act; or

69. (F) the acquisition of shares in, or the assets  
70. of, it regulated financial institution requiring approval  
71. under section 3 of the Bank Holding Company  
72. Act of 1956 or section 408 (c) of the National  
73. Housing Act;

74. (4) the term "primary savings service area" means  
75. a compact area contiguous to a deposit facility from  
76. which such facility obtains or expects to obtain  
77. more than one-half of its deposit customers; and

78. (5) the term "consumer deposit" means a time or  
79. savings deposit or demand deposit owned by one or  
80. more individuals in an amount less than \$100,000.

## 81. COMMUNITY REINVESTMENT PROGRAMS AND 82. PROCEDURES

83. Sec. 4. Each appropriate Federal financial supervisory  
84. agency shall develop programs and procedures for carrying  
85. out the purposes of this Act. Such programs and procedures  
86. shall include-

87. (1) requiring that in connection with an application  
88. for a deposit facility, the applicant

89. (A) delineate the primary saving, service area  
90. for the deposit facility;

91. (B) analyze the deposit and credit needs of  
92. such area and how the applicant proposes to meet  
93. those needs;

94. (C) indicate the proportion of consumer deposits  
95. obtained from individuals residing in the primary savings  
96. service area by the deposit facility that  
97. will be reinvested in that area; and

98. (D) demonstrate how the applicant is meeting  
99. the credit needs of the primary savings service areas  
100. in which it or its subsidiaries have already been  
101. chartered to do business;

102. (2) using, as factors to be considered in approving  
103. applications for deposit facilities, the applicant's record  
104. in meeting the credit need, of the primary savings service  
105. ice areas in which it or its subsidiaries have already  
106. been chartered to do business, and its proposal for meeting  
107. the credit needs of the primary savings service area  
108. associated with the pending application;

109. (3) permitting and encouraging community, consumer,  
110. or similar organizations to present testimony at

111. hearings on applications, for deposit facilities on how well  
 112. the applicant has met or is proposing to meet the credit  
 113. needs of the communities served by or to be served by  
 114. the applicant or its subsidiaries; and  
 115. (4) requiring periodic reports from regulated financial  
 116. institutions concerning the amount of consumer  
 117. deposits obtained from and the amount of credit extended  
 118. in the institutions' primary savings service areas and  
 119. making such reports available to the public.
120. ANNUAL REPORT
121. SEC. 5. Each appropriate Federal financial supervisory  
 122. agency shall include in its annual report to the Congress  
 123. a section outlining the actions it has taken to carry out its  
 124. responsibilities under this Act.
125. EFFECTIVE DATE
126. SEC. 6 Regulations to carry out the purposes of this  
 127. Act shall be published by each appropriate Federal financial  
 128. supervisory agency, and shall take effect no later than one  
 129. hundred and eight days after the date of enactment of this  
 130. Act.

## **APPENDIX B**

### **TITLE IV –COMMUNITY REINVESTMENT**

Sec. 401. This title may be cited as the “ Community Reinvestment Act of 1977”. Sec 402. (a) The Congress finds that –

- (1) regulated financial institutions are required by law to demonstrate that their deposit facilities serve the convenience and needs of the communities in which they are chartered to do business.
  - (2) the convenience and needs of communities include the need for credit services as well as deposit services; and
  - (3) regulated financial institutions have continuing and affirmative obligation to help meet the credit needs of the local communities in which they are chartered.
- (b) It is the purpose of this title to require each appropriate Federal financial supervisory agency to use its authority when examining financial institutions, to encourage such institutions to help meet the credit needs of the local communities in which they are chartered consistent with the safe and sound operations of such institutions.

Sec. 403. For the purpose of this title –

- (1) the term “appropriate Federal financial supervisory agency” means –
  - (A) the Comptroller of the Currency with respect to national banks.
  - (B) the Board of Governors of the Federal Reserve System with respect to State charter banks which are members of the Federal Reserve System and bank holding companies;
  - (C) the Federal Deposit Insurance Corporation with respect to State chartered banks and savings banks which are not members of the Federal Reserve System and the deposits of which are insured by the Corporations; and
  - (D) the Federal Home Loan Bank Board with respect to institutions the deposits of which are insured by the Federal Savings and Loan Insurance Corporation and to savings and loan holding companies:

- (2) the term "regulated financial Institution" means an insured bank as defined in section 3 of the Federal Deposit, Insurance Act or an insured institution as defined in section 401 of the National Housing Act;
- (3) the term "application for a deposit facility" means an application to the appropriate Federal financial supervisory agency otherwise required under Federal law or regulations there under for-
  - (A) a charter for a national bank or Federal savings and loan. association;
  - (B) deposit insurance in connection with a newly chartered State bank, savings and loan association or similar institution;
  - (C) the establishment of a domestic branch or other facility with the ability to accept deposits of a regulated financial Institution;
  - (D) the relocation of the home office or a branch office of a regulated financial institution;
  - (E) the merger or consolidation with, or the acquisition of the assets, or the assumption of the liabilities of a regulated financial institution requiring approval under section 28(c) of the Federal Deposit Insurance Act or under regulations issued under the authority of title IV of the National Housing Act; or
  - (P) the acquisition of shares in or the assets of a regulated financial institution requiring approval under section 3 of the Bank Holding Company Act of 1956 or section, 408(e) of the National Housing Act;
- and
- (4) the term "primary savings service area" means a compact area contiguous to a deposit facility from which such facility obtains or expects to obtain more than one-half of Its deposit customers.

Sec. 404. In connection with its examination of a financial institution, the appropriate Federal financial supervisory agency

- (1) assess the institutions record of meeting the credit needs of it primary savings service area consistent with the safe and sound operations of such institutions; and
- (2) take such record into account in its evaluation of an application for a deposit facility by such institution.

Sec. 405. Each appropriate Federal financial supervisory agency shall include in its annual report to the Congress a section outlining tile actions it has taken to carry out its responsibilities under this title.

Sec. 406. Regulations to carry out the purposes of this title shall be published by each appropriate Federal financial supervisory agency and shall take effect no later than one hundred and eighty days after the date of enactment of this title.

## **APPENDIX C-1**

### **Title VIII – COMMUNITY REINVESTMENT**

Sec. 801. This title may be cited as the "Community Reinvestment Act of 1977".

Sec. 802. (a) The Congress finds that-

- (1) regulated financial institutions are required by law to demonstrate that their deposit facilities serve the convenience and needs of the communities in which they are chartered to do business;
- (2) the convenience and needs of communities include the need for credit services as well as deposit services; and
- (3) regulated financial institutions have continuing and affirmative obligation to help meet the credit needs of the local communities in which they are chartered.
- (b) It is the purpose of this title to require each appropriate Federal financial supervisory agency to use its authority when examining financial institutions, to encourage such institutions to help meet the credit needs of the local communities in which they are chartered consistent with the safe and sound operation of such institutions.

Sec. 803. For the purposes of this title –

(1) the term. "appropriate Federal financial supervisory agency" means –

(A) the Comptroller of the Currency with respect to national banks;

(B) the Board of Governors of the Federal Reserve System with respect to State chartered banks which are members of the Federal Reserve System and bank holding companies;

(C) the Federal Deposit Insurance Corporation with respect to State chartered banks and savings banks which are not members of the Federal Reserve System and the deposits of which are insured by the Corporation; and

(D) the Federal Home Loan Bank Board with respect to institutions the deposits of which are insured by the Federal Savings and Loan Insurance Corporation and to savings and loan holding companies;

(E) the merger or consolidation with in the acquisition of the assets, or the assumption of the liabilities of a regulated financial institution requiring approval under sections 18(c) of the Federal Deposit Insurance Act or under regulations issued under the authority of title IV of the National Housing Act; or

(F) the acquisition of shares in or the assets of, a regulated financial institution requiring approval under section 3 of the Bank Holding Company Act of 1956 or section 408© of the National Housing Act.

Sec. 804. In connection with its examination of a financial institution, the appropriate Federal financial supervisory agency shall-

(1) assess the institutions record of meeting the credit needs of its entire community, including low and moderate income neighborhoods, consistent with the safe and sound operation of such institution; and

(2) take such record into account in its evaluation of an application for a deposit facility by such institution.

Sec. 805. Each appropriate Federal financial supervisory agency shall include in its annual report to the Congress a section outlining the actions it has taken to carry out its responsibilities under this title.

Sec. 806. Regulations to carry out the purposes of this title shall be published by each appropriate Federal financial supervisory agency, and shall take effect no later than 390 days after the date of the enactment of the title.