Community Reinvestment Act Public Hearing August 17, 2010

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Overview

Wall Street's casino mentality and hubris were, by broad consensus, the proximate cause of the Great Recession, not its underlying cause. Even if the Street is better controlled in the future, the structural reason for the Great Recession still haunts America. That reason is America's surging inequality.

Looking back we see that in 1928 the richest 1 percent of Americans received 23.9 percent of the nation's total income. After that, the share going to the richest 1 percent steadily declined. By the late 1970s the top 1 percent raked in only 8 to 9 percent of America's total annual income. But after that, inequality began to widen again, and income re-concentrated at the top. By 2007 the richest 1 percent were back to where they were in 1928—with 23.5 percent of the total.

Each of America's two biggest economic crashes occurred in the year immediately following these twin peaks—in 1929 and 2008. This is no mere coincidence. When most of the gains from economic growth go to a small sliver of Americans at the top, the rest don't have enough purchasing power to buy what the economy is capable of producing. America's median wage, adjusted for inflation, has barely budged for decades. Between 2000 and 2007 it actually dropped. Under these circumstances the only way the middle class can boost its purchasing power is to borrow. As housing prices rose, Americans turned their homes into ATMs. But such borrowing has its limits. When the debt bubble finally burst, vast numbers of people couldn't pay their bills, and banks couldn't collect.

The problem isn't that typical Americans have spent beyond their means. It's that their means haven't kept up with what the growing economy could and should have been able to provide them.

A second parallel links 1929 with 2008: when earnings accumulate at the top, people at the top invest their wealth in whatever assets seem most likely to attract other big investors. This causes the prices of certain assets—commodities, stocks, dot-coms or real estate—to become wildly inflated. Such speculative bubbles eventually burst, leaving behind mountains of near-worthless collateral.

The crash of 2008 didn't turn into another Great Depression because the government learned the importance of flooding the market with cash, thereby temporarily rescuing some stranded consumers and most big bankers. But the financial rescue doesn't change the economy's underlying structure. Median wages are continuing their downward slide, and those at the top continue to rake in the lion's share of income. That's why the middle class still doesn't have the purchasing power it needs to reboot the economy, and why the so-called recovery will be so tepid—maybe even leading to a double dip. It's also why America will be vulnerable to even larger speculative booms and deeper busts in the years to come.

The structural problem began in the late 1970s, by which time a wave of new technologies (air cargo, container ships and terminals, satellite communications and, later, the Internet) had radically reduced the costs of outsourcing jobs abroad. Other new technologies (automated machinery, computers and ever more sophisticated software applications) took over many other jobs (remember bank tellers? telephone operators? service station attendants?). By the '80s, any job requiring that the same steps be performed repeatedly was disappearing—going to counties with lower wages and little, if any, environmental and worker protections, or into software. Meanwhile, as the pay of most workers flattened or dropped, the pay of well-connected graduates of prestigious colleges and MBA programs—the so-called "talent" who reached the pinnacles of power in executive suites and on Wall Street—soared.

Companies were allowed to slash jobs and wages, cut benefits and shift risks to employees (from you-can-count-on-it pensions to do-it-yourself 401(k)s, from good health coverage to soaring premiums and deductibles). The biggest companies went global. Washington deregulated Wall Street while insuring it against major losses, turning finance—which until recently had been the servant of American industry—into its master, demanding short-term profits over long-term growth and raking in an ever larger portion of the nation's profits. And nothing was done to impede CEO salaries from skyrocketing to more than 300 times that of the typical worker (from thirty times during the Great Prosperity of the 1950s and '60s), while the pay of financial executives and traders rose into the stratosphere.

The reason is simple. As money has risen to the top, so has political power. Politicians are more dependent than ever on big money for their campaigns. Modern Washington is far removed from the Gilded Age, when, it's been said, the lackeys of robber barons literally deposited sacks of cash on the desks of friendly legislators. Today's cash comes in the form of ever increasing campaign donations from corporate executives and Wall Street, their ever bigger platoons of lobbyists and their hordes of PR flacks.

None of us can thrive in a nation divided between a small number of people receiving an ever larger share of the nation's income and wealth, and everyone else receiving a declining share. The lopsidedness not only diminishes economic growth but also tears at the social fabric of our society. The most fortunate among us who have reached positions of relative economic power and success depend on a stable economic and political system. That stability rests on the public's trust that the system operates in the interest of us all. Any loss of such trust threatens the well-being of everyone. We must enact real reform because we are a sensible nation, and reform is the only sensible option we have.

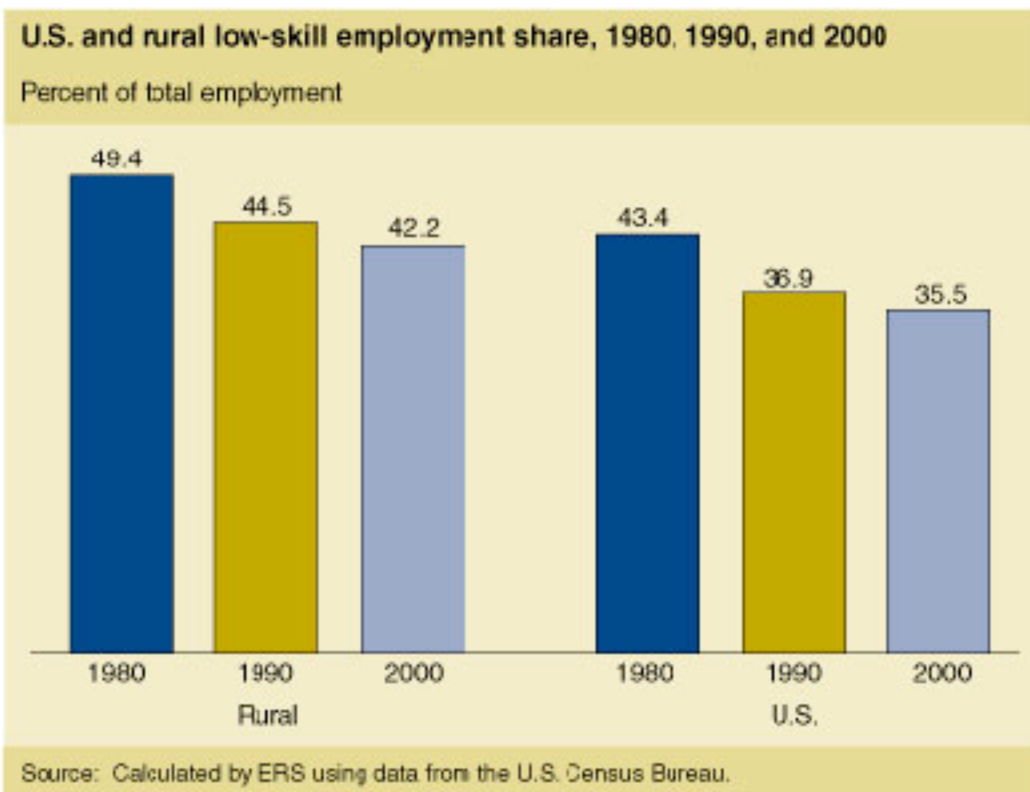
The Community Reinvestment Act, if properly implemented and enforced, is a vital component of any plan to respond to the collective financial hole we find ourselves in and and I am encouraged by the open process adopted by the agencies in drafting new regulations. CRA's core objective of meeting the credit needs of underserved communities requires a holistic approach to change and needs to be focused on the long term real outcomes in communities. Financial institutions should not be encouraged by CRA regulation to enter into short term transactional activities that produce no measurable long-term benefits but should be rewarded for being part of collaborations that meet objective needs of communities and LMI families over the course of years.

Geographic Coverage

The Community Reinvestment Act, as currently enforced, concentrates most activities in large urban areas. This practice leaves many poor rural communities to stagnate.

Data clearly shows that poverty rates are higher in rural America than they are in the cities. Only one in 20 urban counties has a poverty rate above 20 percent. For remote rural counties, the ratio is one in five. The counties that have been poor over a period of decades are overwhelmingly rural.

One explanation is that there are structural problems in rural areas that, in a sense, enforce poverty. There are fewer good jobs in rural areas. (See chart below.) At one time, the theory was that as extractive industries (mining, oil and agriculture) grew more efficient, they had less need for workers — and that change created a labor surplus that depressed wages. Work in rural America tends to pay minimum wages, offer less security and provide fewer opportunities for advancement.



There appears to be another reason for rural America's persistent poverty, however, and that's migration. There is a growing body of evidence that rural communities are poor because poor people are moving there:

"Mark Nord studied data collected in the Census that tracked the movement of people between 1985 and 1990. The U.S. Department of Agriculture economist found that people who were working-age and poor moved in large numbers to poor rural counties. It was also true that poor people left downtrodden rural counties, Nord found. But even more poor people moved in.

And Nord found that during the same period richer residents moved out of poor, rural counties. There was double impoverishment: Poor people moved in and rich ones moved out — leaving the counties poorer still, with fewer prospects for better times.

"Anthropologist Janet Fitchen interviewed poor families in a rural New York State community. She wrote in 1995 that the already poor place "became a migration destination for urban poor people, causing dramatic increases in poverty rate, welfare rolls and service needs." The rural community collected the spillover of poor people fleeing the more expensive cities.

"In an unpublished paper, Nord later wrote that people with less than a high school education moved disproportionately to rural communities. Rural America had an outsized number of people without high school diplomas not because rural schools were failing to graduate their students but because poorly educated people were migrating in.

"Finally, this spring Monica Fisher, the Oregon State economist, concluded that "the higher incidence of poverty in nonmetro compared with metro America is partly explained by a sorting into nonmetro areas of people with personal attributes associated with human impoverishment." Rural America was poor in part because it attracted poor people, many of whom came from cities.

All these scholars of rural economies and communities found the same phenomenon: People were sorting. Poorer people, those with less education and fewer skills, were sorting themselves into a large number of rural counties. And people with more education and higher skills were sorting themselves out.

There are a number of reasons poor people are moving to poor rural areas. Housing is cheaper there. People are drawn to these places in part because it's less expensive to live there. Jobs in poor, rural places often require few skills, and those jobs may also be attracting people who couldn't find jobs in urban areas where jobs demand more education and training.

In other words, as economies in booming cities improve, pushing up wages and housing prices, people with fewer skills and less education will move to more rural, high poverty counties. Unknowingly, cities are exporting their poor to rural areas.

All of this highlights the need to deliver CRA activities in a more comprehensive and equitable fashion.

Affiliate Activities

The activities of lenders' non-depository affiliates such as mortgage companies have become a much larger part of the banking industry's day-to-day operations. Currently institutions can elect to have their subsidiary or affiliate lending activity counted in CRA performance evaluations. If the banking institution elects to include affiliate activity, it cannot be done selectively. For example, the institution cannot "cherry pick" loans that would be favorably considered under the law while ignoring loans to middle- or higher-income borrowers.

On the surface this seems like a reasonable regulation. However, when you dig deeper you find that many institutions simply structure their business in ways that are designed to subvert this rule. By moving desirable parts of the business under one the banking charter and excluding those with less desirable characteristics, institutions can exclude all affiliate lending and receive an “outstanding” rating while continuing to pursue lines of business that are contrary to the spirit of the regulation.

Allowing optional inclusion of affiliate lending allows banks to structure their operations in a manner that can be, and based on my experience is, used to mask questionable lending and other deficiencies and inequities in lending practices.

Institutions should not be able to manipulate the examination process through creative corporate structures. The only way to solve this issue and create a level playing field is to include all affiliate lending in every examination.

Access to Banking

Building assets requires the building of knowledge and information about finances. The weakening of the job-based system of retirement saving and health insurance means Americans need to understand the complex financial marketplace, and navigate an array of products and services available from a variety of financial services providers.

For low- to middle-income families who have fewer financial resources to begin with, a solid grounding in personal finance and a clear understanding both of the options and of the implications of financial decisions are critically important. America has a stake in ensuring that all families have access to adequate financial products and services, including banking, savings, and wealth-building opportunities, so that they can confidently take control of their personal finances.

Low-income households often lack access to banking accounts and face high costs for transacting basic financial services through check cashers and other alternative financial service providers. These families find it more difficult to save and plan financially for the future. Living paycheck to paycheck leaves them vulnerable to medical or job emergencies that may endanger their financial stability, and lack of longer-term savings undermines their ability to improve skills, purchase a home, or send their children to college. Additionally, high cost financial services and inadequate access to bank accounts may undermine widely shared societal goals of reducing poverty, moving families from welfare to work, and rewarding work through incentives such as the Earned Income Tax Credit.

Access to financial services is critical to success in the modern American economy. Most households can take access to a bank account for granted. Yet 22% of low-income families—over 8.4 million families earning under $25,000 per year—lack the most basic financial tool, a bank account.1 These “unbanked” households and other “underbanked” low- and moderate-income individuals face high costs, relative to their income, for basic financial services. For example, a worker earning $12,000 a year would pay approximately $250 annually just to cash payroll checks at a check cashing outlet.2 Low-income workers often turn to tax preparation services and costly refund loans to access their government tax refund check under the Earned Income Tax Credit (EITC). The costs of these basic financial transactions can undermine public initiatives that help families move from welfare to work, and can diminish the effectiveness of the EITC in lifting families out of poverty and encouraging workforce participation.

Low-income families, particularly those without bank accounts, often lack any regular means to save. These families, often lacking alternative forms of financial resources, need to save, however, as a cushion against short-term crises, such as injury or job loss, as well as for longer-term goals, including buying a home, sending their children to college, or retirement. Of course, a central reason that low-income people find it difficult to save is that they have low incomes, but evidence suggests that low-income people can save if they have structured mechanisms to do so. The unbanked are also largely cut off from mainstream sources of credit, whether for short-term consumer borrowing or home ownership, because, without a bank account, it is more difficult and more costly to establish credit or qualify for a loan. Even those low-income persons who have an account may, in effect, be “underbanked”: They may rely on check cashers to cash their payroll checks; they may lack an institutionalized means to save, such as through payroll deduction plans; or they may not have, or may have tapped out, credit cards, and turn to relatively high cost forms of short-term credit, such as payday loans, to meet their liquidity needs.

Alternative financial service (AFS) providers—including check cashers, money transmitters, payday lenders, title lenders, and tax preparation services that provide refund anticipation loans—are providing a wide range of financial services in low-income communities. For example, check cashers provide a means for unbanked employees to convert their paychecks to cash. Payday lenders provide short-term credit to borrowers who cannot access credit cards or are already at credit limits. There are benefits to this market segmentation, and for low-income consumers, it is likely that without such services, they would be even less able to fulfill their financial services needs. Still, such services often come at a high cost to low- and moderate-income borrowers. Some portion of these high costs may be endemic to the nature of the transactions. These are paper- and labor-intensive transactions involving small dollar amounts, conducted on behalf of consumers with low wealth and often uncertain or poor credit history. These transactions are undertaken largely by financial service providers, which, unlike insured depositories, lack direct access to the payments system for check clearance. Moreover, the fixed costs of lending show up in higher prices for loans of short duration and small amounts. Yet some portion of the costs—and consumer problems—can be traced to the patchwork of state and federal law that governs these providers.

While the mainstream financial system works well for most Americans, many low- and moderate-income individuals face a number of barriers to bank account ownership. First, regular checking accounts may not make economic sense for many lower-income families. For example, consumers who cannot meet account balance minimums pay high monthly fees, and most banks levy high charges for bounced checks, which families living paycheck to paycheck can ill afford. Second, many unbanked persons may not qualify for conventional bank accounts because of poor credit history or prior problems with managing a bank account. While some persons undoubtedly pose undue risk for account ownership, many could responsibly use bank accounts structured for their needs. In particular, accounts that do not permit overdrafts would reduce the risk associated with customers despite previous problems with the banking system and would diminish the need to sort out customers who had bounced checks in the past, except for those who were judged to have committed fraud. Third, while many low-income communities contain both banking institutions and alternative financial services providers, in some communities, banks, thrifts, and credit unions are not as readily accessible as in higher-income areas. Fourth, financial institutions may be reluctant, given low expected returns, to invest in research, product development, account administration, bank personnel training, marketing, and financial education necessary to expand financial services to lower- income clientele. That is, banking the poor is unlikely to be seen as sufficiently profitable for many banks to incur the up-front costs of entering this market, particularly because most banks are not institutionally organized to focus on this market segment. Fifth, the technologies that would make it less costly for low-income persons to use banking services are subject to positive network externalities. These externalities may slow the adoption of electronic forms of income receipt and payment.

A 2000 Treasury study found that a worker earning $12,000 a year would pay approximately $250 annually just to cash payroll checks at a check-cashing outlet, in addition to fees for money orders, wire transfers, bill payments, and other common transactions. Almost all of the checks cashed at check cashers pose relatively low risk: Payroll payments—with low credit risk that could be directly deposited by electronic means, instead of by check, into bank accounts, at significantly lower costs to the payment system—constitute 80% of checks cashed at these check cashing outlets. Another 16% are government benefit checks, which again pose low risk. A large portion of these checks could presumably be directly deposited into bank accounts at relatively low cost—if low-income people had bank accounts.

The CRA must be all inclusive, requiring check cashers, money transmitters, payday lenders, title lenders, tax preparation services that provide refund anticipation loans and others to operate under the same regulations as mainstream financial institutions. Only when all parties are playing by the same rules will financial equity be possible for LMI communities and families.

Community Development

The mortgage crisis has had a larger impact on Low- and Moderate-Income (LMI) communities that those observed in the broader population. Subsequently, the needs of LMI communities now are more pronounced now than they have been in the past. Foreclosures are effecting LMI borrowers and communities in epidemic proportions. The effects of foreclosures have an impact that goes far beyond individual homeowners: they also impact neighboring homeowners by driving down property values; they affect others in the community who suffer the effects of vacancy, crime, and disinvestment; and they affect the renters who occupy 2-4 family homes and the apartment buildings that recently have begun to see disinvestment and even foreclosure. It is important for the regulators and lenders implementing CRA to have a clear understanding of the credit needs of these communities and be in a position to support timely responses to these problems.

Regulators must improve their capacity and effectiveness when it comes to measuring credit needs given the rapid deterioration of neighborhood credit conditions that we have seen recently. As credit needs of individuals and communities change over time, regulators and financial institutions require timely and rigorous measures of need in order for the CRA to remain effective and relevant.

Regulators should also use this opportunity to review how to value and encourage CRA initiatives that have major positive impacts on communities and household credit needs over time because they were thoughtfully designed and provide measurable long-term benefits. Thoughtful Investment in organizations providing services that benefit entire communities, especially if done as part of a targeted, coordinated local strategy, are invaluable assets to LMI communities and should be recognized by regulators during the examination process.

Community Development must be approached in a holistic way that takes into account all the potential impacts on the broader community and financial institutions must be held accountable for ensuring that stated project outcomes are achieved.

About Measured Outcomes LLC

At Measured Outcomes, we are committed to success for nonprofits, businesses, foundations, and the entire community.

We believe that together we can achieve great things!

Nonprofits, in conjunction with individuals, businesses, corporate responsibility programs, governments and foundations, spend millions of dollars each year on programs to improve the lives of people through direct service, education and philanthropy. We all intuitively know that our work is making a difference, but few organizations can provide the information necessary to prove it. There is no other area of industry, or personal finance, where so much money is invested without first forecasting what tangible results are to be achieved, and developing systems to benchmark against those expectations.

The question becomes how do organizations and investors measure outcomes when the goals involve complex social and quality of life issues?

Measured Outcomes was founded on the belief that what gets measured gets done! We leverage our community development, business, and nonprofit experience to help bridge the gap between funders, community groups, and service providers.

No matter how complex the program, we help your organization define success and align strategies with business marketing, foundation giving, and community goals. We work with you to develop systems that measure results and communicate them effectively to stakeholders.

Measured Outcomes' Integrated Engagement Model™ helps nonprofits, funders, and other interested parties partner effectively to the maximum benefit of all.

Whether we are helping develop new programs, or restructuring existing ones, we work with you, and your partners, to make certain that no resource is wasted and that all outcomes are measured effectively and communicated in a way that is immediately accessible and tailored to the needs of businesses, government, nonprofits, and the community.

About Stephen Blakley

Stephen is an economic development and community investment professional. He has spent his entire professional career working to improve the quality of life in communities throughout the US. He holds a degree in Environmental Science from UC Davis.

Before founding Measured Outcomes he worked for ten years at Wells Fargo, a Fortune 100 company, developing, monitoring, and communicating the company's Economic Development and Community Reinvestment activities throughout the United States. During his tenure the company received recognition as a national leader in helping low- and moderate-income communities and families succeed.

Prior to Wells Fargo he worked as an administrator for nonprofit agencies providing direct services to clients with chronic diseases and severe disabilities. As an administrator he was responsible for client services, fiscal stability and, operations of the organizations. He has also worked on several local and national political campaigns as a community advisor and field operative.

In addition to his work with Measured Outcomes, he continues to serve on nonprofit boards and committees providing financial, compliance, fund development, grant management, and demographic expertise.