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Subcommittee on Consumer Protection and Financial Institutions

Thank you very much for this opportunity to comment on "The Community Reinvestment Act: Assessing the Law's Impact on Discrimination and Redlining." While the nature of banking has changed dramatically since the passage of the CRA, the inequalities and injustices the CRA was designed to remedy have only gotten worse. The law must be updated and strengthened. In my testimony, I will first step back from the details of CRA reform to consider the social contract between banks and the people and the ways in which the historic context of the CRA points to banks' public obligations. Second, I will show how changes in the banking sector that occurred during the deregulatory era have exacerbated the problems the CRA was meant to remedy. And lastly, I will suggest ways the CRA can be reformed and modernized to be responsive to those who need it and also suggest that it might be time for even stronger medicine.

BANKING AND THE SOCIAL CONTRACT

The underlying theory of the CRA is that banks have public duties because they are essentially public institutions. Banks cannot function, and have never functioned, without extensive federal government support. In passing the CRA in 1977, Senator William Proxmire, Chairman of the Senate Committee on Banking, Housing and Urban Affairs alluded to the dependent nature of the bank-state relationship. He stated that the CRA was based on a "widely shared assumption" that "a [bank's] public charter conveys numerous economic benefits and in return it is legitimate for public policy and regulatory practice to require some public purpose . . ." The Senator claimed that banks are "a franchise to serve local convenience and needs" and therefore "it is fair for the public to ask something in return."[1] This is the social contract that banks have with the public—the quid pro quo is that the federal government insures bank deposits, protects banks from liquidity shortages, and provides access to the central payments system; banks, in turn, play an essential intermediary role in carrying out the economic policy priorities of the government, financing the expansion of the economy, and serving the credit and transactional needs of their customers and local communities.

Every aspect of banking—deposits, loans, and simple financial transactions—relies on a robust network of support from the federal government. Banks need this support, without which their customers would lack sufficient trust to permit them to function properly. Trust is the currency

[1] Warren L. Dennis, *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* (Lafayette, Ind.: Credit Research Center, Krannert Graduate School of Management, Purdue University, 1978).

of banks and historically, only the full faith and credit of the US Treasury has been able to infuse banks with the support necessary to induce public trust.[2]

Banks enjoy access to very low risk and inexpensive funding in the form of customer deposits, which is made possible by FDIC deposit insurance backstopped by the US Treasury.[3] This federal government support amounts to a state subsidy, which makes the banking sector unlike any other business that has to compete for funding. Federally-insured deposits enable banks to lend out the great majority of the deposits they receive and enjoy the money-multiplier effect that "fractional reserve lending" enables.[4] The reliance on customer deposits is what led Supreme Court Justice Louis Brandeis to consider banks to be essential public utilities. Brandeis explained that banks operate using "other people's money" and therefore "deposit banking should be recognized as one of the businesses 'affected with a public interest.'"[5]

Many bank loans are also supported by the federal government. Mortgages and student loans are guaranteed, bundled, or subsidized by the FHA or the Government Sponsored Entities (GSEs) Fannie Mae, Freddie Mac, Ginnie Mae, and Sallie Mae.[6] And when these institutions fail, they too have the implicit backing of the Federal Government as we saw with numerous GSE bailouts during the financial crisis of 2008. These GSEs enable banks to make exponentially more loans than what their customer deposits alone would allow. At the crux of our banking system, then, is a state-enabled credit system.

Each time a bank sends or accepts money from another financial institution, they are using the Federal Reserve's payments system. Only banks have access to this payments system, which means that banks enjoy a monopoly on the central financial network of U.S. commerce.[7] Individuals

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[2] BRAY HAMMOND BANKS AND POLITICS IN AMERICA FROM THE REVOLUTION TO THE CIVIL WAR (1991); Charles W. Calomiris & Gary Gorton, *The Origins of Banking Panics: Models, Facts, and Bank Regulation* in FINANCIAL MARKETS AND FINANCIAL CRISES (R. Glen Hubbard ed., 1991); Gary Gorton & Lixin Huang, *Bank Panics and the Endogeneity of Central Banking*, 53 J. Monetary Econ. 1613 (2006); Gary Gorton & Lixin Huang, *Banking Panics and the Origin of Central Banking* (Nat'l Bureau of Econ. Res., Working Paper 9137, 2002).

[3] The FDIC insurance fund is backstopped by the US Treasury: when the FDIC fund dipped into default in 2018, the US Treasury stood behind the fund. James A. Wilcox, *MIMIC: A Proposal for Deposit Insurance Reform*, 9 J. Fin. Reg. and Compliance 338 (2001). Joe Peek and James A. Wilcox, *The Fall and Rise of Banking Safety Net Subsides*, in *Too Big to Fail: Policies and Practices in Government Bailouts,* ed. Benton E. Gup (Westport, CT: Praeger Publishers, 2004), 177-178.

[4] Piergiorgio Alessandri & Andrew G. Haldane, "Banking on the State," November 6, 2009, based on presentation at *Federal Reserve Bank of Chicago 12th Annual International Banking Conference on "The International Financial Crisis: Have the Rules of Finance Changed?*, September 25, 2009, 1

[5] Louis D. Brandeis, *Other People's Money and how the Bankers use it* (New York: Frederick A. Stokes Company, 1914) 18.

[6] David J. Reiss, *Accessible Credit, Sustainable Credit and the Federal Housing Administration*, 36 Banking & Fin. Services Pol'y Rep. 1 (2017). Board of Governors of the Federal Reserve System, Federal Reserve Monthly Statistical Releases: Consumer Credit (2018); Office of Management and Budget, Budget of the U.S. Government FY2019 Analytical Perspectives Table 19-1 (2018). Over $6.5 Trillion mortgages, the majority of the market, are backed by GSEs. Urban Institute, Housing Finance at a Glance, (April 2018), https://www.urban.org/sites/default/files/publication/98669/housing_finance_at_a_glance_a_monthly_chartbook_june_2018_0.pdf (43.7% Fannie Mae, 27.3% Freddie Mac, and 28.9% Ginnie Mae) (there is a total of 10.6 trillion dollars in total household mortgages). Ibid. The Federal Government has over 2.5 trillion dollars in total guaranteed loans as of year-end 2017. OFFICE OF MANAGEMENT AND BUDGET, BUDGET OF THE U.S. GOVERNMENT FY2019 ANALYTICAL PERSPECTIVES Table 19-1 (2018). CONGRESSIONAL BUDGET OFFICE, Fair-Value Estimates of the Cost of Selected Federal Credit Programs for 2015 to 2024, (May 22, 2014), https://www.cbo.gov/publication/45383.

[7] Morgan Ricks, *Money as Infrastructure*, 3 Colum. Bus. L. Rev. 757 (2018).

and businesses are required to have a bank account in order to send and receive checks free of charge, but those who do not or cannot have a bank account must pay fees each time they use or send money.

Bank deposits, bank loans and bank transactions—all supported by the Federal Government. And that's just the tip of the iceberg of government support of the banking sector. When a bank has a liquidity crisis, it can rely on the Federal Reserve's discount window, which provides banks loans at below market interest rates.[8] And let us not forget that during the financial crisis, the Federal Reserve rescued a failing banking industry with equity infusions, loans, guarantees, asset purchases, and other forms of financial support.[9]

And still, there's more. Since the financial crisis, the Federal Reserve has practiced unprecedented monetary policy. Three rounds of Quantitative Easing (QE) have left the Fed holding over $4 trillion in bank assets—assets that were so worthless they were pushing the banks that held them towards insolvency.[10] Another less well-known example of bank-friendly monetary policy is Interest On Excess Reserves ("IOER"). In a payment that seems to violate what people may assume to be the laws of the market and basic common sense, the Federal Reserve pays banks billions of dollars in interest on the excess cash the banks are holding in reserves at the Fed. In fact, these are excess funds that were created by the Fed during QE in the first place.[11] In just one year, the Federal Reserve paid about $7 billion in interest to commercial banks, including more than $100 million to Goldman Sachs and more than $900 million to JPMorgan Chase.[12] The hope of this payment is that the banks would play the intermediary role outlined in the social contract and that the payments would "pass through" the banks and make it to the public to spur the economy, but the IOER is in fact being absorbed by the banks and bolstering the profits and returns to shareholders.[13]

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[8] The interest rate at the discount window is 0.5% higher than the Fed Funds rate, which is currently 2.5%. Kimberly Amadeo, *Federal Reserve Discount Window and How it Works* The Balance (2018), https://www.thebalance.com/federal-reserve-discount-window-3305923; Board of Governors of the Federal Reserve System, "Monetary Policy," http://www.federalreserve.gov/monetarypolicy/openmarket.htm (accessed January 18, 2015).

[9] Most of the bailout provisions relied on the Federal Reserve's 13(3) emergency lending powers. Niel Willardson & LuAnne Pederson, "Federal Reserve Liquidity Programs: An Update" (June 2010), *available at* http://www.minneapolisfed.org/research/pub_display.cfm?id=4451 ; Alexander Mehra, *Legal Authority in Unusual and Exigent Circumstances: The Federal Reserve and the Financial Crisis* (U. Pa. J. Bus. L. 2011 update), at https://www.law.upenn.edu/journals/jbl/articles/volume13/issue1/Mehra13U.Pa.J.Bus.L.221(2010).pdf

[10] https://www.federalreserve.gov/monetarypolicy/bst_recenttrends.htm

[11] Due to the massive amounts of money created by QE, bank reserves swelled to over $1.7 trillion as of October 2018. This overage is called excess reserves and even though it was created by the Federal Reserve, banks earn interest on these reserves. These reserves comprise a substantial portion of the nation's monetary base. The Federal Reserve is using this payment, called an "administered rate" as its primary monetary policy tool post QE. Federal Reserve Bank of St. Louis, Required Reserves of Depository Institutions, (Nov. 8, 2018) https://fred.stlouisfed.org/series/REQRESNS. *See* Walker F. Todd, *The Problem of Excess Reserves, Then and Now*, Working Paper 763, LEVY ECONOMICS INSTITUTE (May 2013)

[12] House of Rep. Committee on Financial Services, Hearing: Monetary Policy and the State of the Economy (Feb. 10, 2016).

[13] This policy, which was meant to encourage lending by banks, has turned into a subsidy that in fact discourages lending because banks can earn more by "lending" customer deposits to the Federal Reserve than they can pursuing consumer or business loans. Excess funds can be rolled over at no cost and liquidated on the same day, making excess reserves more attractive than lending. Darrell Duffie & Arvind Krishnamurthy, *Passthrough Efficiency in the Fed's New Monetary Policy*

The social contract between banks and the public is that they enjoy a monopoly on payments system, receive subsidized funding through insured deposits, benefit from loan guarantees and rely on a smorgasbord of protection and support during a crisis. In return, they must be instruments of economic policy by connecting the citizenry to credit and financial markets.[14] Viewed from this lens, it becomes clear that the government and by extension "the people" must be entitled to demand a banking sector that serves all of us, and not just the few from whom they can make the most profit.

This was exactly the insight on which the CRA was based. Senator Proxmire's words bear repeating today as Congress considers making changes to the CRA. In passing the original CRA legislation, the Senator explained that banks are like public institutions because their "collective decisions help to shape the communities we live in, our economic well-being, and have a profound impact on our daily lives." A bank charter, granted by the government, "entitles the holder to government support, [including] the authority to operate new deposit facilities," which "conveys a substantial economic benefit to the applicant." He said that a bank charter was "a *semi-exclusive franchise* to do business… with a financial back-up from the U.S. Treasury" and "ready access to low cost credit through the Federal Reserve Banks or the Federal Home Loan Banks." "In return for these benefits," the Senator explained:

> "…financial institutions are required by law and regulatory policy to serve the 'convenience and needs' of their communities. The 'needs' of a community clearly include the need for credit services as well as deposit services…. The proposed legislation directs the bank regulatory agencies to use their influence to award applications for deposit facilities in a way that will benefit local communities as well as bankers."[15]

The Erosion of the Social Contract during the Deregulatory Era

The nature of banking and bank regulation has changed significantly since the original passage of the CRA; deregulation, fast-paced technological change and a globally networked banking sector have transformed the financial industry. The deregulatory era that began shortly after the passage of the CRA was a slow and steady shift in both the conceptual and practical understanding of the bank-state relationship. Instead of treating banks as quasi-public institutions with spillover gains for private individuals, they were treated as purely private enterprises ruled by market forces to be set free from government meddling. In the brief history that follows, I will show how the social contract was slowly eroded as the industry went through wave after wave of deregulation, leaving

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Setting 2016 Economic Policy Symposium Proceedings, https://kansascityfed.org/~/media/files/publicat/sympos/2016/2016duffie.pdf?la=en; Morgan Ricks, *Money as Infrastructure*, 3 COLUM. BUS. L. REV. 757 (2018). Walker F. Todd, *The Problem of Excess Reserves, Then and Now*, Working Paper 763, Levy Economics Institute (May 2013) http://www.levyinstitute.org/publications/the-problem-of-excess-reserves-then-and-now.

[14] Mehrsa Baradaran, *Banking and the Social Contract*, 89 NOTRE DAME L. REV. 1283 (2014).

[15] 123 Cong. Rec. 406 (1977).

the CRA the lone survivor of the many laws and regulations that once required banks to fulfill their obligations to the public.

A major front of deregulatory efforts was the repeal of restrictions on bank size and location. Unit banking, wherein a single bank operates in a single region, was the norm in U.S. banking for almost two centuries.[16] When the CRA was passed, strict regulatory prohibitions on bank size and location were still in effect. These restrictions were meant to force banks to stay tied to one community in order to serve that community's credit needs as well as to restrict the size and conglomerate power of the banking sector.[17] During the deregulatory era, the banking industry fought these restrictions on size and scope, claiming that they should be treated like other corporations. Indeed, technology, globalization, and modern capital market development required that regulations be updated. However, in addition to lifting onerous and outdated restrictions, the government also abandoned previous banking policy goals, such as avoiding concentrations of power and favoring localism for the sake of equality in access.[18] Over several decades, barriers to bank expansion and consolidation fell and banks began to branch nationwide and grow through mergers and acquisitions.[19] The official repeal of unit banking came in 1994 through the passage of the Riegle-Neal Interstate Banking and Branching Efficiency Act, which allowed banks to open branches across state lines.[20] The purpose of the Act was baked right into the title: to increase bank "efficiency."[21] Congress and the regulators' focus changed from their post-New Deal goal of keeping

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[16] Most banks did not open branches outside of a state, or even within a state in many cases, for much of U.S. banking history. The McFadden Act, enacted in 1927, specifically prohibited interstate branching by allowing each national bank to branch only within the state in which it is situated. McFadden Act, § 3, 44 Stat. 1228 (1927). However, prior to the McFadden Act, most states prohibited interstate branching and many prohibited branching within the state. Federal Reserve Committee on Branch, Group, and Chain Banking, *Branch Banking in the United States* (Federal Reserve System, 1992), 8, 210. Eighteen states banned branch banking within the state, nine allowed it, and fourteen allowed it with certain restrictions. Ibid. at 215-16. A majority of states in 1895 had no mention of branches in their laws. In some states silence has been taken as permitting and in others as forbidding branches.

[17] Richard S. Carnell, Jonathan R. Macey, and Geoffrey P. Miller, *The Law of Financial Institutions,* 5th ed. (New York: Aspen Publishers, 2013), 13; Calomiris & Haber, *Fragile by Design,* 459.

[18] FDIC, HISTORY OF THE EIGHTIES – LESSONS FOR THE FUTURE, 177-178 (2018) ("Before the 1980s, new charters had been granted on the basis of community need. Under the Reagan administration, the FHLBB and the Office of the Comptroller of the Currency approved any application as long 'as the owners hired competent management and provided a sound business plan.' The devastating consequences of adding many new institutions to the marketplace, expanding the powers of thrifts, decontrolling interest rates, and increasing deposit insurance coverage, coupled with reducing regulatory standards and scrutiny, were not foreseen.").

[19] "The relaxation of restrictions on intrastate branching and interstate banking that took place in the 1980s and early 1990s facilitated both mergers and consolidations. While only 16 states permitted unrestricted intrastate branching in 1984, by 1994 the number had risen to 40. Similarly, while 42 states restricted interstate combinations of banking charters in 1984, by 1994 only Hawaii retained this restriction. The Interstate Banking and Branching Efficiency (or Riegle-Neal) Act of 1994 allowed full interstate branching, which made possible the interstate consolidation of charters within banking companies." FDIC, "Community Banking Study," (December 2012), 2. Available at https://www.fdic.gov/regulations/resources/cbi/report/cbi-full.pdf. Another felled barrier was inter-state branching, which means that a single bank can operate branches in more than one state without having to comply with the corporate and banking forms of that state. Federal law lifted the restrictions in 1997, but the federal law allowed banks to branch only through acquisitions or mergers.

[20] Bill Medley, *Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994*, Federal Reserve History (September 1994), https://www.federalreservehistory.org/essays/riegle_neal_act_of_1994.

[21] Farlex Financial Dictionary, Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, https://financial-dictionary.thefreedictionary.com/Riegle-Neal+Interstate+Banking+and+Branching+Efficiency+Act+of+1994 ("The Act streamlined banking regulation in the United States . . . .").

banks small, local, and safe to ensuring that banks stayed competitive, which meant that they were profitable and efficient.

Mergers have meant the creation of large TBTF banks, but they have also meant banking deserts and the wholesale abandonment of low-profit customers. The pursuit of efficiency led to cost-cutting and branch closing, especially in low-profit areas. Between 1984 and 2017, the amount of bank branches fell by over 66% from 14,500 to below 5,000.[22] Most stand-alone banks were swallowed up by the large banks or they simply failed. Large banks are much more efficient and profitable than small banks and soon they dominated the banking market.[23] The result of a series of mergers and expansions was predictable—today, a handful of behemoth banks control most of the country's assets and small community banks struggle to compete.[24] The financial crisis accelerated the decline of small community banking. From 2008-2013, banks shut 2,000 branches—93% of which were located in zip codes where the household income was below the national median.[25] LMI communities have lost branches as high income communities have gained them.[26] Projections show that 40% more bank branches will close in the next few years.[27] According to new bank merger data published by the Federal Reserve, the Fed set two records in 2018: the highest-ever approval rate for

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[22] Allison Prang, *Thousands of Bank Branches are Closing, Just Not at These Banks*, WALL ST. J. (June 15, 2018 2:35 p.m. EST), https://www.wsj.com/articles/the-bank-branch-is-dyingjust-not-at-these-banks-1529055000.

[23] Non-community banks reported a Return on Investment (ROI) that averaged 35 basis points higher than community banks. Ibid. In 1984, disparity in asset sizes between community banks (those with less than $1 Billion in assets) and non-community banks was 12 to 1; in 2011, it was 74 to 1, and as of the 3rd Quarter of 2018 it is 90 to 1. Quarterly Banking Profile, 12 FDIC Qtrly 1 (2018), https://www.fdic.gov/bank/analytical/qbp/2018sep/qbp.pdf. Today, only 8% of bank charters are non-community banks, but these banks account for 63% of all bank branches and 93% *of total assets*. In fact, just the top 5 banks control *over 40%* of all bank deposits. 2018-2022 STRATEGIC PLAN, THE FDIC AND THE BANKING INDUSTRY: PERSPECTIVE AND OUTLOOK, https://www.fdic.gov/about/strategic/strategic/bankingindustry.html; *Quarterly Banking Profile*, 12 FDIC Qtrly 1 (2018), https://www.fdic.gov/bank/analytical/qbp/2018sep/qbp.pdf; The Five Largest U.S. Banks Hold More Than 40% Of All Deposits, Forbes (Dec. 14, 2017), https://www.forbes.com/sites/greatspeculations/2017/12/14/the-five-largest-u-s-banks-hold-more-than-40-of-all-deposits/#50af566916aa.

[24] For example, Bank of America makes 1/3 of all business loans, Wells Fargo provides 1/4 of all mortgages, and Chase holds 12% of all of our collective cash. The six largest banks hold 70% of all assets in the financial system, up from 37% just 5 years ago. Just four of the largest banks (Bank of America, Citigroup, JP Morgan Chase, and Wells Fargo) control almost *50% of all bank assets*. JP Morgan holds $2.4 Trillion in assets, which is the size of England's economy. And they are just getting bigger. The top 4 banks make about 10 times more now than they did five years ago. This expansion and growth not only changed the size, but the nature of the industry. These megabanks became more profitable, took on more risks, and expanded into more markets. Stephen Gandel, "By every measure, the banks are bigger," *Fortune,* September 13, 2013, http://fortune.com/2013/09/13/by-every-measure-the-big-banks-are-bigger/. Trefis Team, "Why Wells Fargo Will Soon Have the Largest Deposit Base Among U.S. Banks," *Forbes*, September 15, 2014, http://www.forbes.com/sites/greatspeculations/2014/09/15/why-wells-fargo-will-soon-have-the-largest-deposit-base-among-u-s-banks/.

[25] Frank Bass & Dakin Campbell, Predator Targets Hit as Banks Shut Branches Amid Profits, *Bloomberg*, May 2, 2013. Available at http://www.bloomberg.com/news/2013-05-02/post-crash-branch-closings-hit-hardest-in-poor-u-s-areas.html.

[26] Bass & Campbell, "Predator Targets Hit as Banks Shut Branches Amid Profits." See also Nelson D. Schwartz, "Bank Closings Tilt Toward Poor Areas," *New York Times,* February 22, 2011. Available at http://www.nytimes.com/2011/02/23/business/23banks.html?pagewanted=all&_r=0 ("In low-income areas, where the median household income was below $25,000, and in moderate-income areas, where the medium household income was between $25,000 and $50,000, the number of branches declined by 396 between 2008 and 2010. In neighborhoods where household income was above $100,000, by contrast, 82 branches were added during the same period.").

[27] Stephen Greer & Bob Meara, Branch Boom Gone Bust: Predicting a Steep Decline in US Branch Density, *CELENT,* April 30, 2013. www.celent.com/reports/branch-boom-gone-bust-predicting-steep-decline-us-branch-density.

bank M&A proposals (95%) and the quickest-ever time to approval, especially for mergers that received adverse comments from the public due to CRA non-compliance, which were approved in less than four months.[28]

In addition to the inevitable conglomeration of the banking sector, several bedrock principles of banking policy were slowly rejected during the deregulatory era, including, most importantly, the idea that banks had unique public responsibilities. Reflecting the historical understanding that banks were to serve the public, the public mission of banks was written into the text of nearly all major banking legislation, including the Bank Holding Company Act (BHCA), The National Banking Act ("NBA"), the Riegle-Neal Act, and others.[29] For banks to gain approval for mergers, expansions, or new activities, these laws require that the bank's primary regulator must determine whether the change will benefit the public and reject the activity if it does not. Before the deregulatory era, regulators considered potential monopoly concerns, excessive bank size, and a community's access to bank services.[30] Today, the question of whether a merger or change in activity

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[28] BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *Semiannual Report on Banking Applications Activity: July 1-December 2018* (Mar. 2019), https://www.federalreserve.gov/publications/files/semiannual-report-on-banking-applications-20190329.pdf.

[29] For example, under the Bank Holding Act, bank holding companies that wish to acquire or merge with a bank or nonbank or partake in certain nonbanking activities must undergo a public benefit test. 12 U.S.C. § 1842(c)(2) (2011); 12 U.S.C. § 1843(j)(2)(A) (2011). In order to pass the public benefits test under the Bank Holding Company Act, a bank holding company, in its application process, must prove more than simply no adverse effects would arise; it must prove some reasonable expectation of public benefits. However, if the Board finds some adverse effects then it is required to find more than speculative or scant public benefits. Money Station, Inc. v. Bd. of Governors of Fed. Reserve System, 81 F.3d 1128, 1134 (D.C. Cir. 1996). The BHC public benefit test requires affirmative public benefits rather than mere absence of adverse effects. Roger E. Alcaly, *Neither Convenient Nor Needed: The Convenience and Needs and Public Benefits Tests of the Bank Holding Company Act*, 96 BANKING L. J. 325, 328 (1979). Section 1842(c)(2) requires the Federal Reserve Board to consider the convenience and needs of the community affected by the merger or acquisition of a bank by a bank holding company. 12 U.S.C. § 1842(c)(2) (2011). Section 1843(j)(2)(A) lays out a cost benefit analysis of nonbanking activity or acquisition for regulators to consider such as increased convenience, competition, and efficiency that must outweigh adverse effects such as concentration of resources, unfair competition, conflicts of interest, or unsound banking practices. 12 U.S.C. § 1843(j)(2)(A) (2011). 12 C.F.R. § 225.26 (2005). Regulation Y lists public benefit factors the Board must consider when approving non-banking proposals, such as "greater convenience, increased competition, and gains in efficiency." The test asks, for example, whether the merger or proposed activity will lessen competition or whether the change will "meet the convenience and needs of the community." Id. 12 C.F.R. § 225.13(b)(3) (2005). The National Bank Act also requires the OCC to analyze public benefits, such as community development, philanthropy, and the needs of the community, when national banks are formed or acquire or merge with other national or state banks interstate. The Federal Reserve's Regulation Y also includes a public benefit test for approving mergers or new activities by banks. 12 U.S.C. § 24, eighth, eleventh (2008). The Reigle-Neal Act's public benefit test requires interstate bank merger applicants to prove that the merger will not violate concentration limits. 12 U.S.C. § 1831u(b)(2), (3) (2011).

[30] *See,* Mehrsa Baradaran, Banking and the Social Contract, 89 NOTRE DAME L. REV. 1283 (2014) for a review of agency opinions, specifically related to BHC's seeking merger approvals, from the 1970s until today, revealing that the public benefit test has become less meaningful over time. In the 1970s, banks were often denied merger approvals because the proposed merger did not meet public needs and convenience. Regulators often made a rigorous inquiry into the needs of the community and provided examples of how a specific merger would enhance the welfare of the community; *See e.g.* North Shore Capital Corp., 58 Fed.Res.Bull. 809, 810 (F.R.B.), 1972 WL 27551 (denied BHC formation because public needs and convenience was already being met). First Alabama Bancshares, Inc., 57 Fed.Res.Bull. 404, 412 (F.R.B.), 1971 WL 24190 (approving merger because Alabama was one of the least economically developed states and due to anticompetitive monopoly concerns); Texas Commerce Bancshares, Inc., 58 Fed.Res.Bull. 984, 986 (F.R.B.), 1972 WL 27646 (new services included petroleum financing services that the community currently lacked and needed), Western Michigan Corp., 63 Fed.Res.Bull. 506, 508 (F.R.B.), 1977 WL 39198 (lending capacity increased, upgraded agricultural loan services, and new savings programs). A Fed study revealed that the Board consistently cited six types of public benefits: improvements of convenience and needs of the community, increased competition, operational efficiency,

results in a public benefit is reduced to a single factor: compliance with the CRA.[31] The public benefit test that was originally a core part of fundamental banking legislation has been outsourced to the CRA. The CRA thus stands as the last bulwark of the public's interest in the social contract between banks and the government.[32] Yet even as the CRA is meant to encapsulate the entirety of the public benefit inquiry, or perhaps because of it, banks have resisted the mandate to comply with the CRA.[33]

In fact, a sort of double-speak entered into the regulatory lexicon with respect to the public benefit test. When regulators engaged in the required *public* benefit inquiry, the question morphed into a finding of whether a new activity would be "efficient" or "profitable" *for the bank*.[34] For

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expanded financial resources for the firm to be acquired and/or the bank holding company, improved management for the acquired firm, and other benefits unique to the particular case. Michael A. Jessee & Steven A. Seelig, *An Analysis of the Public Benefits Test of the Bank Holding Company Act*, Federal Reserve Bank of New York, Monthly Review, 151 (June 1974). The study further finds that, as of February 1974, only twenty-nine orders of denials were published, and in every denial, the primary reason was reduction of existing or potential competition. *Id.* at 157.

31 The OCC has stated that it gauges "public benefit" using a cost-benefit analysis and compliance with the Community Reinvestment Act. *See,* Decision of the Office of the Comptroller of the Currency on the Applications of Bank of America Trust Company of Florida, N.A., Boca Raton, Florida, Bank of America Florida Interim National Bank, Boca, Raton, Florida, and Bank of America National Trust & Savings Association, San Francisco, California, Corporate Decision #97-52, 8-9 (June 25, 1997) (available at http://www.occ.gov/static/interpretations-and-precedents/jul97/cd97-52.pdf); Nationsbank Corp. Charlotte, North Carolina, 1993 WL 741754 at *7 (F.R.B.) (fourth-largest commercial bank in US merger application approved where the only mention of "convenience and needs factors" was that the bank had favorable CRA ratings).

32 The GLB Act was the first major banking regulation that did away with any public benefit inquiry. The act was passed in 1999 after two decades of deregulation. The Act does reinforce the CRA requirements for public benefit by codifying that nothing in the Act changes these requirements. 12 U.S.C. § 1811 (note) (1999). This last concession was a major sticking point in the legislation and was heavily contested, but written into the Act in order to get it passed. *The Gramm-Leach-Bliley Act P.L. 106-102 Financial Services Modernization Working Summary No. 4***,** Gibson Dunn & Crutcher, LLP, at 84 (Dec. 16, 1999), *available at* http://cyber.law.harvard.edu/rfi/casebook/gibson.pdf ("The CRA provisions of the Act were the most contentious and were the last major provision to be agreed to."). The compromise was that the GLB Act required the Federal Reserve and the Treasury Department to study whether these programs were generally *profitable*. 12 U.S.C. § 2901, § 2908 (1999). The Federal Reserve found that the majority (61%) were generally profitable for large institutions. Report by the Board of Governors of the Federal Reserve System, submitted to the Congress pursuant to section 713 of the Gramm-Leach-Bliley Act of 1999 (July 17, 2000) (available at http://www.federalreserve.gov/communitydev/files/cra_cratext.pdf). The Dodd-Frank Act also does not include a "public benefit" test anywhere in its text. The act does, however, implement a new policy consideration under the BHCA cost-benefit analysis. Regulators must now also consider whether a merger or acquisition will create detrimental systemic risk to the financial industry and whether that risk outweighs any benefit expected from the merger or acquisition. 12 U.S.C. § 5301 (2012).

33 See Richard S. Carnell, Jonathan R. Macey, and Geoffrey P. Miller, *The Law of Financial Institutions,* 5th ed. (New York: Aspen Publishers, 2013), 328; Michael S. Barr, "Banking the Poor," *Yale Journal on Regulation* 21 (2004): 121, 603 ("CRA's broad standards and 'enforcement' mechanisms . . . have long been derided by both proponents and detractors of CRA. Community advocates urge stricter rules and harsher consequences of failure. Bankers lament the lack of clear rules or safe harbors and the intrusive role of the public."); Charles W. Calomiris et al., "Housing-Finance Intervention and Private Incentives: Helping Minorities and the Poor," *Journal of Money, Credit & Banking* 26 (1994): 634, 673 (stating that "the vagueness of the CRA has led to arbitrary enforcement"); Keith N. Hylton, "Banks and Inner Cities: Market and Regulatory Obstacles to Development Lending," *Yale Journal on Regulation* 17 (2000): 191, 203 (explaining that enforcement of the CRA has been uneven and unpredictable).

34 *See* Mehrsa Baradaran, *Banking and the Social Contract*, 89 NOTRE DAME L. REV. 1283 (2014). For example, a merger involving the second-largest banking corporation in Minnesota was approved by the Federal Reserve, in the face of strong anti-competitive concerns, because of "the significant public benefit of *resolving the capital deficiency of an impaired institution* in a private transaction without cost to the federal deposit insurance funds." Another approved merger

example, in the application and accompanying files for the recent BB&T and SunTrust merger, the only reference to the public benefit test was that the banks had a "satisfactory or above" CRA rating.[35] The merger, if approved, will be the largest since the financial crisis, creating the sixth largest bank in the country, and will likely result in large scale bank branch closures across the Southeast.[36] Yet according to recent regulatory decisions, insofar as a bank is in compliance with the CRA, the merger is deemed to benefit the public regardless of how many branches are closed and banking deserts are created.[37]

Not only were banks relieved of public-*serving* functions over the last few decades, but even laws *protecting* consumers from their harmful products were weakened by the regulators tasked with their enforcement. Consumer regulations that were deemed expensive, outdated, inefficient or that hindered bank competition were rolled-back. The OCC and the OTS infamously announced that national banks did not have to follow state consumer protection laws—or state laws designed to protect their citizens—using the doctrine of "federal preemption of state law." Here, the state laws protecting consumers were "preempted" by exactly zero consumer-protecting federal laws.[38] The rationale was that these public-protecting laws rendered banks less efficient and profitable by limiting the kinds and amounts of loans that these banks could make.[39] The OCC's pre-emption of

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determined the public benefit of "[providing] Applicant greater resources for expansion and greater flexibility for diversification of business activities…[which would] allow Applicant to *continue to compete effectively* with other large Rhode Island financial organizations…." Norwest Holding Co., 76 Fed.Res.Bull. 873, 875 (F.R.B.), 1990 WL 319857. Citizen's Financial Group, Inc.*,* 71 Fed.Res.Bull. 473, 475 (F.R.B.), 1985 WL 68579; Citizen's Financial Group, Inc.*,* 71 Fed.Res.Bull. 473, 475 (F.R.B.), 1985 WL 68579 ("[approval] will provide Applicant greater resources for expansion and greater flexibility for diversification of business activities…[and] thus should allow Applicant to *continue to compete effectively* with other large Rhode Island financial organizations….")(emphasis added).

35 Application to the Board of Governors of the Federal Reserve System by BB&T Corp. at 10, 12, 27, 29, 49–171, 82–83 (March 8, 2019) (OMB No. 7100–0121); Pub. Ex. Vol., at 22, 43, 219–27, Application to the Board of Governors of the Federal Reserve System by BB&T Corp. at Federal Reserve (March 8, 2019) (OMB No. 7100–0121); Req. for Additional Information at 3, Application to the Board of Governors of the Federal Reserve System by BB&T Corp. (March 29, 2019) (OMB No. 7100–0121).

36 J. Scott Trubey, *SunTrust Merger with BB&T Mean Another Bank HQ Leaving for Charlotte*, THE ATLANTA JOURNAL-CONSTITUTION (Feb. 7 2019), https://www.ajc.com/news/local-govt--politics/suntrust-merger-with-means-another-bank-leaving-for-charlotte/YN1k8G53eaX3Kl08MT4FEI/;
BB&T/SUNTRUST APPLICATION AND RELATED MATERIALS: APPLICATION MATERIALS, https://www.federalreserve.gov/foia/bbt-suntrust-application-materials.htm; Notice by Federal Reserve, Formations of, Acquisitions by, and Mergers of Bank Holding Companies, 84 Fed. Reg. 9340 (March 14, 2019), https://www.federalregister.gov/documents/2019/03/14/2019-04737/formations-of-acquisitions-by-and-mergers-of-bank-holding-companies.

37 A 1977-1978 Federal Reserve survey concluded that it was difficult to demonstrate whether "the public interest standards of the act have fostered the public welfare significantly." Joseph E. Rossman & B. Frank King, *Convenience and Needs: Holding Company Claims and Actions*, Federal Reserve Bank of Atlanta, Working Paper, 1-2 (Aug. 1977); David R. Allardice, *Convenience and Needs Considerations: A Post-Audit Survey*, Federal Reserve Bank of Chicago, Research Paper No. 78-2, 2-8 (Sept. 1978). Anthony W. Cyrnak, *Convenience and Needs and Public Benefits in the Bank Holding Company Movement*, in THE BANK HOLDING COMPANY MOVEMENT TO 1978: A COMPENDIUM 286 (1978).

38 The OCC and the Office of Thrift Supervision (OTS) announced comprehensive preemption to protect all national banks and thrifts from state consumer protection laws. The rationale was that these public-protecting laws rendered banks less efficient and profitable by limiting the kinds and amounts of loans that these banks could make. DEP'T of the Treasury, *Financial Regulatory Reform: A New Foundation: Rebuilding Financial Supervision and Regulation*, 2, 7 (2009), http://www.treasury.gov/initiatives/Documents/FinalReport_web.pdf; OCC Interpretive Letter No. 999 (Mar. 9, 2004), https://www.occ.gov/topics/licensing/interpretations-and-actions/2004/int999.pdf.

39 The OCC and the Office of Thrift Supervision (OTS) announced comprehensive preemption to protect all national banks and thrifts from state consumer protection laws. Department of the Treasury, *Financial Regulatory Reform: A New*

state consumer protection laws led inevitably to increased subprime lending, which led to the subprime crisis. So too did the OCC's decisions to permit banks to engage in derivatives trading. Profitability and efficiency had become of such paramount concern that the OCC even supplanted the requirement of "safety and soundness" for "efficiency". In a series of interpretative letters and regulatory decisions, the OCC allowed banks to engage in derivatives speculation using the metric of profitability and efficiency.[40]

During the era of rapid deregulation, there was an ongoing debate among banks, politicians, and scholars about what it meant to be a bank in the modern world. Amidst the deregulatory push, dissenters attempted to speak out. Gerald Corrigan, President of the Federal Reserve Bank of New York, wrote a 1982 essay entitled "Are Banks Special?" Corrigan answered the question in the affirmative and stated that:

> Banks and bank regulators have long since recognized the importance of banks acting in ways that preserve public confidence….Deposit insurance and direct access to [the Fed as] the lender of last resort are uniquely available to banks to reinforce that public confidence. Indeed, deposit insurance and access to the lender of last resort constitute a public safety net under the deposit taking function of banks. The presence of this public safety net reflects a long-standing consensus that banking functions are essential to a healthy economy. However, the presence of the public safety net uniquely available to a particular class of institutions also implies that those institutions have *unique public responsibilities* and may therefore be subject to implicit codes of conduct or explicit regulations that do not fall on other institutions.[41]

Corrigan's view was in line with the history of banking, but it was out of sync in the 1980s, and his view lost this ideological battle. The prevailing theory was that banks would operate through market rules and market discipline just like other corporations, but market discipline turned out to be a fantasy. The government would not or could not allow banks to suffer market discipline or failure, because banks, indeed, *are special.*

The truth is that while the banking industry was rejecting any public duties, they were all the while being supported by public funds. It was inevitable that in an era of deregulated banks, there

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Foundation: Rebuilding Financial Supervision and Regulation (2009), http://www.treasury.gov/initiatives/Documents/FinalReport_web.pdf, 2, 7. Interpretive Letter No. 999, John D. Hawke, Jr., Comptroller of the Currency, to Barney Frank, Ranking Member, Committee on Financial Services, U.S. House of Representatives, March 9, 2004, http://www.occ.gov/static/interpretations-and-precedents/aug04/int999.pdf.

[40] For example, Saule Omarova reveals how the Office of the Comptroller (OCC), through a series of interpretive letters, allowed banks to engage in highly risky derivatives transactions by examining only their potential profits. However, derivatives, now a robust industry that dwarfs the nation's capital markets and GDP, were laden with risks and have since exposed many banking institutions to heightened vulnerability. Saule T. Omarova, *The Quiet Metamorphosis: How Derivatives Changed the "Business of Banking"*, 63 Univ. Miami L. Rev. 1041 (2009).

[41] E. Gerald Corrigan, *Are Banks Special?*, Minneapolis Fed. Reserve Bank (Jan. 1 1983), https://www.minneapolisfed.org/publications/annual-reports/are-banks-special (emphasis added).

would be large failures. What was surprising was that the market rules would only be applied when banks were making profits and not when they ultimately failed. Instead of allowing the market to enforce its discipline and allow banks to fail, as was dictated by the repudiation of the social contract, the government stepped in and bailed out the banking industry. [42] The incongruity of it all was articulated by Simon Johnson and James Kwak:

> Never before had so much taxpayer money been dedicated to save an industry from the consequences of its own mistakes. In the ultimate irony, it went to an industry that had insisted for decades that it had no use for the government and would be better off regulating itself—and it was overseen by a group of policymakers who *agreed* that governments should play little role in the financial sector.[43]

Ultimately, this period of transition resulted in an asymmetrical erosion of the social contract with banks. The government had waived the bank's restrictions and obligations, but kept the safety nets. The unprecedented Federal response exposed the myth that banks operate in the free market and were subject to market discipline. To be fair, some bankers and supporters of complete deregulation advocated for a complete market model and an imposition of market discipline without any government support. However, most policymakers and bankers, wary of panic-inducing failures and a system-wide credit crisis, supported a regime of government insurance, bailouts, and guarantees. But the ideological pendulum had swung so far that even post-crisis banking reforms did not challenge the predominant framework of banks as independent market actors.

I am well aware that the modifications being discussed at this hearing are not radical changes to banking regulation, but I believe understanding how the history of incremental deregulatory "reforms" over the last several decades has eroded the social contract is critical to contemplating the future role of the CRA in addressing the needs of vulnerable communities. Congress and regulators must be watchful that reforms promising "modernization" and "efficiency" do not become a Trojan Horse hiding even more deregulation relieving banks of their last remaining duties to the public. When a regulatory change promises more efficiency or ease of compliance, we must take a step back and ask a few questions: efficient for whom? And why should efficiency be our primary concern? Most importantly, we must ask a foundational question: what kind of banking sector would best meet the needs of the public and how can we design laws to achieve that outcome?

THE PEOPLE

The problems that the CRA was created to address have not been solved. If anything, they have become worse:

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[42] See, e.g., Richard A. Posner, A Failure of Capitalism: The Crisis of '08 and the Descent into Depression 45-46 (2009); Brian J.M. Quinn, The Failure of Private Ordering and the Financial Crisis of 2008, 5 N.Y.U. J.L. & Bus. 549, 555-62 (2009) (arguing that a root cause of the financial crisis of 2008 was "financial innovation and the corresponding long-term move towards liberalization and self-regulation").

[43] Simon Johnson & James Kwak, 13 BANKERS: THE WALL STREET TAKEOVER AND THE NEXT FINANCIAL MELTDOWN 164 (2010).

- Today, 1 in 4 families is unbanked or underbanked.[44]
- LMI families that have to use alternative financial services spend approximately 10% of their income—the equivalent of their food budget—in fees and interest just to use their money.[45]
- More than 40% of US the population would have to borrow money if they needed $400 for an emergency expense.[46]
- Families who have to rely on payday, title, or pawn lending to make ends meet pay APRs of up to 400% and often end up in a cycle of debt. This includes many government employees who were furloughed during the shutdown and had to resort to payday loans to meet basic expenses.[47]
- The rise of the high cost payday lending sector was a direct result of deregulation: as community banks failed and left banking deserts in their wake, the payday lenders filled the void. In 1977 when the CRA was passed, payday lending was a non-existent industry—today there are more payday lender locations than McDonalds and Starbucks.[48]
- State usury caps have steadily increased and become difficult to enforce due to state and federal deregulation of historic usury laws. States without an effective cap attract many nationwide lenders who can export the state's rates to their customers.[49]
- Bank closures are not spread out evenly—93% of bank closings are in LMI communities.[50]
- Rural America has lost *over half* of its banks in the last few decades and 1 in 8 communities is a banking desert.[51]

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[44] Economic Inclusion, *The 2017 National Survey of Unbanked and Underbanked Households*, FEDERAL DEPOSIT INSURANCE COMPANY (2017) https://economicinclusion.gov/surveys/2017household/.

[45] Mehrsa Baradaran, HOW THE OTHER HALF BANKS, 1-2. (2015).

[46] https://www.federalreserve.gov/publications/2018-economic-well-being-of-us-households-in-2017-dealing-with-unexpected-expenses.htm

[47] https://www.consumerfinance.gov/ask-cfpb/what-is-a-payday-loan-en-1567/; https://www.marketwatch.com/story/one-potential-winner-from-the-government-shutdown-payday-lenders-2019-01-08

[48] Economist John Caskey and others have noted that it was only when the banks left that the fringe banking industry exploded. Payday lending emerged during the 1990s "to serve a void created by the withdrawal of traditional lenders from the very small loan market." Caskey, *Fringe Banking: Check-Cashing Outlets, Pawnshops, and the Poor*, 3; There Are More Payday Lenders in U.S. Than McDonald's, NBC NEWS, (March 24, 2013), https://www.nbcnews.com/business/economy/there-are-more-payday-lenders-u-s-mcdonalds-n255156. https://www.newyorker.com/business/currency/the-high-cost-for-the-poor-of-using-a-bank.

[49] *Marquette Nat. Bank of Minneapolis v. First of Omaha Service Corp.,* 439 U.S. 299(1978); Christopher Peterson, *Taming the Sharks* (Akron, OH: University of Akron Press, 2004), 108. Utah Department of Financial Institutions, *Interest Rates* (2019) https://dfi.utah.gov/general-information/consumer-tips/interest-rates/.

[50] NCRC Research, *Banking Deserts in America*, NATIONAL COMMUNITY REINVESTMENT COALITION (June 2017) http://maps.ncrc.org/bankdeserts/index.html;. Frank Bass & Dakin Campbell, *Study Finds Latest Bank Brach Closing Strike Hardest in Poor Neighborhoods*, Bloomberg News (May 2, 2013) https://www.stltoday.com/business/local/study-finds-latest-bank-branch-closings-strike-hardest-in-poor/article_b33a4103-280f-5b3c-9754-3086de4b0070.html.

[51] Housing Assistance Council, *The Community Reinvestment Act and Mortgage Lending in Rural America* 22 (Jan. 2015) http://www.ruralhome.org/storage/documents/publications/rrreports/rrr-cra-in-rural-america.pdf.

- Banks no longer offer small loans and though some promise "free checking," there are hidden fees and requirements that repel most small balance customers.[52]
- Many LMI customers choose not to have a bank account because of punishingly high fees, which have increased recently. Banks charge average overdraft fees of $33 per overdraft. This has become a profitable business with some large regional banks reporting that fees account for 40% of their income. Together, consumers paid $17 billion in overdraft fees in 2015, according to the Center for Responsible Lending (about $53 for every American). [53]
- In terms of the effects of redlining, median white wealth is twelve times higher than median black wealth. Thirty-seven percent of black families and 33 percent of Latino families have zero or negative wealth.[54] Thirty-four percent of black children grow up in a high poverty area.[55] Black families lost 53% of their wealth during the financial crisis due to foreclosures and the compounding effects of redlining and the racial wealth gap.[56]

In order to get beyond the numbers, it's important to understand the real human costs of poverty and inequality. Children growing up poor are 5 times more likely to die of accidents and much more likely to have serious chronic illnesses.[57] Growing up in poverty exposes children to toxic chemicals and repeated stress and trauma that can make permanent changes to a person's brain structure and function.[58] Today where a child is born determines her future life span, salary, future poverty, career opportunity, likelihood of ending up in prison, and her general life outcomes more

[52] Most banks require balances of $1,500 to avoid fees on their basic accounts. Lisa J. Servon, *The High Cost, for the Poor, of Using a Bank*, New Yorker (Oct. 9, 2013), https://www.newyorker.com/business/currency/the-high-cost-for-the-poor-of-using-a-bank. Abby Vesoulis, *Millions of Americans Can't Afford a Checking Account. The Post Office Could Fix That*, TIME (Aug. 7, 2018); GOVERNMENT ACCOUNTABILITY OFFICE, COMMUNITY REINVESTMENT ACT, OPTIONS FOR TREASURY TO CONSIDER TO ENCOURAGE SERVICES AND SMALL-DOLLAR LOANS WHEN REVIEWING FRAMEWORK (Feb. 2018), https://www.gao.gov/products/GAO-18-244.

[53] Rebecca Borné, Peter Smith, and Rachel Anderson, *Center for Responsible Lending, How Overdraft Fees Harm Consumers and Discourage Responsible Bank Products,* May 2016; https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl_broken_banking_may2016.pdf; Bob Pisani, *Bank Fees Have Been Growing Like Crazy*, CNBC (July 21, 2017 10:38 AM) https://www.cnbc.com/2017/07/21/the-crazy-growth-of-bank-fees.html. According to the Federal Financial Institutions Examination Council, JP Morgan made $1.9 billion from overdraft charges last year, Wells Fargo made $1.8 billion, and Bank of America made $1.7 billion.

[54] INSTITUTE FOR POLICY STUDIES, DREAMS DEFERRED (2019), https://ips-dc.org/wp-content/uploads/2019/01/IPS_RWD-Report_FINAL-1.15.19.pdf.

[55] NATIONAL CENTER FOR CHILDREN IN POVERTY, BASIC FACTS ABOUT LOW-INCOME CHILDREN UNDER 18 YEARS (2016), http://www.nccp.org/publications/pub_1194.html.

[56] The racial wealth gap is a direct consequence of a history of bank redlining. MEHRSA BARADARAN, THE COLOR OF MONEY: BLACK BANKS AND THE RACIAL WEALTH GAP (2017); RICHARD ROTHSTEIN, THE COLOR OF LAW: A FORGOTTEN HISTORY OF HOW OUR GOVERNMENT SEGREGATED AMERICA (2017); MORITZ KUHN ET AL., INCOME AND WEALTH INEQUALITY IN AMERICA, 1949-2016 (2018), https://www.ineteconomics.org/uploads/general/Wealthinequality_June2018.pdf. ELIZABETH ANDERSON, THE IMPERATIVE OF INTEGRATION (2013); DOUGLAS S. MASSEY & NANCY A. DENTON, AMERICAN APARTHEID: SEGREGATION AND THE MAKING OF THE UNDERCLASS (Harv. Univ. Press Reprint ed. 1993). LAURA SULLIVAN ET AL., THE RACIAL WEALTH GAP: WHY POLICY MATTERS 10 (2015), https://www.demos.org/sites/default/files/publications/RacialWealthGap_1.pdf [herinafter *Demos/IASP Paper*].

[57] Priyanka Boghani, *How Poverty Can Follow Children into Adulthood*, PBS FRONTLINE (Nov. 22, 2017) https://www.pbs.org/wgbh/frontline/article/how-poverty-can-follow-children-into-adulthood/.

[58] *Id.*

than nearly any other indicator, including her level of education.[59] In some cities, a child born to a family earning a median income will have access to a good school and opportunities for economic mobility while a child born in a different city will not.[60] These are the communities we are talking about when we talk about LMI communities that the CRA is meant to address; these struggling communities are the same communities that banks have been deserting as they search for higher profits and efficiency.

While meaningful access to financial products is not a cure-all for the effects of poverty and historic injustice, no policy effort to change the financial situation of the poor will be meaningful without such access. Banks must play an active role in fixing these problems at the federal level. These problems are too large and too complicated and too entrenched for one law or one industry to solve, but it is imperative that as Congress and bank regulators consider updating the CRA, they consider the real human effects of public policies.

Remembering, Revising and Reestablishing the Social Contract

The CRA is an endangered species. It once stood among a coherent system of bank regulations and regulatory enforcements designed to ensure that banks play a role in public policy and fulfill their obligation to the public. The CRA is the lone survivor of this regulatory tradition. As such, changes to the CRA must avoid further eroding banks' public obligations. We must deliberately reconsider our public interest in financial inclusion for LMI communities. CRA enforcement must be more transparent and less arbitrary, but "ease of compliance" is not a desired outcome in and of itself. If banks' incentives are just to pass the test with the least amount of work and regulators' incentives are to simplify this process to allow them to do that, we are unlikely to see meaningful changes in the problems of exclusion and inequality outlined above. This problem is too big and too important to reduce to simple box-checking. Certainly, this is not the fault of any individual bank, but it is part of a decades long trend of deregulation—often led by the OCC.

The CRA should be revised and strengthened so that it meets the desired outcomes of the law. Bank compliance should be measured against those outcomes. Consider as an example the way that safety and soundness regulation was reformed after the financial crisis through Comprehensive Capital Analysis and Review ("CCAR") stress-tests. Before the financial crisis, safety and soundness compliance was based more or less on regulatory box-checking: CAMELS ratings, risk-weighted capital, PCA governance, and more. These metrics failed to prevent the financial crisis because they failed to capture the complexity of the banking sector and the ways in which banks could use loopholes, derivatives hedges, or off-balance sheet maneuvers to hide risks. The Federal Reserve decided to administer the stress-testing regime after 2008. Because stress testing metrics are not made public, banks cannot "game the test." The stress test focuses on outcomes; the Federal Reserve simply asks whether a large bank has enough capital to withstand the stress scenario. The test takes account of the entire firm's risks, investments, management, and actions to make this determination. Banks that fail the test must raise more capital. While there is debate about whether the stress tests are rigorous enough, the design of the new regulatory regime focuses on outcomes as opposed to process. The CRA can likewise be reformed to focus on outcomes rather than a list of actions taken.

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[59] ENRICO MORETTI, THE NEW GEOGRAPHY OF JOBS (Mariner Books Reprint ed. 2013)
[60] EQUALITY OF OPPORTUNITY PROJECT: NEIGHBORHOODS, http://www.equality-of-opportunity.org/neighborhoods/ (last visited Mar. 7, 2019). MORETTI, *supra* note 8.

The desired outcome of the CRA is for banks to meet basic community banking needs, to play an active role in helping distressed communities, and to fulfill their public-serving duties. Because banks and communities differ significantly from each other, banks should specify their own outcomes and goals in consultation with community groups. Currently, the CRA allows certain banks to offer a "strategic plan" for CRA compliance. According to the FDIC, "The strategic plan enables the institution to tailor its CRA goals and objectives to address the needs of its community consistent with its business strategy, operational focus, and capacity and constraints."[61] Few banks have taken up this option, but I believe that this is the most outcome-oriented model and should be required of all banks. These strategic plans must be pegged to specific measurable outcomes and not just actions taken. A bank would specify the needs or problems in their region, devise a plan with specified metrics for meeting those needs, including the community partners involved in making and achieving those goals, and make yearly public reports on their progress. This is a way to align incentives in the CRA between the banks, regulators, and the communities they serve. This would require more work for banks and regulators, but would ultimately lead to better results. A few examples of outcome-oriented fixes are the following:

Financial Options rather than Financial Education: Many banks fulfill their CRA obligations by providing financial education classes, yet it is uncertain and unlikely that financial education is effective for LMI communities.[62] Take, for example, the use of expensive AFS products by the unbanked. Many banks offer financial literacy courses advising against these services while they continue to charge overdraft fees to LMI individuals—overdraft fees that push people out of banks and to AFS products. Financial literacy courses also advise against taking out payday loans due to their high interest, but banks do not offer small loans.[63] The missing element is not the education, but the option to have a checking account and small loan options that fits the needs of LMI communities. LMI communities need services, credit, and low-cost accounts—not lectures.

Aligning Incentives: Whenever possible, banks will align their profit incentives with CRA compliance, but often the most profitable investments and loans are not the one that are most useful to the community.[64] Rather than attempting to divert the focus of banks, and only receive an afterthought from those banks in return, the CRA could allow banks to outsource their public duties to organizations like CDFIs, MDIs and other public-serving organizations whose mission it is to meet the financial needs of communities. Banks could make capital investments or provide low-cost loans or other banking services in conjunction with community land trusts, local first-time home-buyer programs, or other local organizations meeting the needs of LMI individuals. These investments should be significant.

Fintech Banks and Assessment Areas: Bank assessment areas must be revised to match changes in the banking sector. The CRA was designed for an era of heavy geographic restrictions and its focus on local assessment areas no longer match a banking sector that sees new Fintech banking options with

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[61] FDIC, *Community Reinvestment Act: Guide to Developing the Strategic Plan*, FEDERAL DEPOSIT INSURANCE CORPORATION 1 (1998) https://www.fdic.gov/news/news/financial/1998/fil9826b.pdf.

[62] Willis, Lauren E. 2011. *"The Financial Education Fallacy." American Economic Review, 101(3).*

[63] Research shows that payday borrowers have exhausted all other sources of credit before relying on payday lenders *Payday Lending in America: Who Borrows, Where They Borrow, and Why*, PEW CHARITABLE TRUSTS (July 19, 2012) https://www.pewtrusts.org/en/research-and-analysis/reports/2012/07/19/who-borrows-where-they-borrow-and-why.

[64] CONGRESSIONAL RESEARCH SERVICE, THE EFFECTIVENESS OF THE COMMUNITY REINVESTMENT ACT 2 (Feb. 28, 2019) *available at* https://fas.org/sgp/crs/misc/R43661.pdf.

regularity. Many, including some regulators, tout Fintech as the non-bank solution to financial inclusion, but in reality, most Fintech providers access the payments systems through partnership with banks. And while banks exist globally, and Fintech companies exist virtually, community needs are local. LMI individuals still need local brick and mortar services such as check cashing, cash deposits, and remittance services. CRA obligation on banks with fintech partnerships should push them to respond to these needs. Bank should either provide free bank accounts to all customers using their Fintech apps for CRA credit or alternatively, their assessment area should track the nationwide footprint of the services provided by their partnering Fintech company. These banks should choose a strategic plan within that assessment area to fulfill their CRA duties.

Is it time for a Public Option?

The government supports banks through trust-inducing insurance, bailouts, liquidity protection, and a framework that allows the allocation of credit to the entire economy. Banks, in turn, operate as the central machinery of the economy by providing transaction services, a medium for trade, and individual and business loans that spur economic growth. This entanglement between the state and the banking system is the social contract written into foundational banking legislation, including the CRA. But relying solely on banks for this work has resulted in the exclusion of a significant portion of the public from the bounty of government support. This is not just a problem of the banking market. It threatens our social fabric through the array of disruptive consequences that follow from the lack of normal banking services and the vicious cycle of impossible loan payments. If the state is so heavily involved in the banking system, it has a direct interest in making sure that the banking system does not create or contribute to such vast inequality.

The CRA is the last remaining tool of regulators to require banks to extend credit beyond their preferred customer base, but banks have resisted engaging in "inefficient" or "unprofitable" transactions. And this is the truth that cannot be avoided—serving the needs of these communities may not be profitable. Yet the democratization of banking is too important a public imperative to be left solely up to the private sector. The supply of credit has always been a public policy issue, with banks functioning as intermediaries. Insofar as the state enables credit markets, deposit accounts and the payments system, all Americans should have equal access to these public utilities. Reasonable and safe bank accounts and credit products provide a smoother path both through and out of poverty. If banks are not providing financial services to the poor, and requiring them to do this is ineffective, inefficient, or otherwise politically fraught, then any serious discussion of financial inclusion must consider a public option.[65]

The most promising path toward a public banking option is to use the existing US Postal Service to extend credit and transaction services to individuals. Not only do many countries enjoy a robust postal banking regime, but our own USPS has a history of providing savings accounts and financial services. American banks long ago deserted the most impoverished communities, but post offices, even two centuries later, have remained—still rooted in an egalitarian mission. There have never been barriers to entry at post offices, and their services have been available to all, regardless of income. The post office, America's oldest instrument of democracy in action, can once again level the playing field.[66]

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[65] *How the Other Half Banks: Exclusion, Exploitation, and the Threat to Democracy,* HARVARD UNIVERSITY PRESS (Oct. 2015)
[66] *Mehrsa Baradaran, It's Time for Postal Banking,* 127 HARV. L. REV. F. 165 (2014)

In conclusion, the CRA must be strengthened in ways that recognize the tremendous task it was created to do and remains undone today. Banks are in a unique position to engage in this effort and have historically been tasked with playing a significant role. But a strong CRA should be only one step in an effort to match for the large inequalities in the credit system, the conglomeration of the banking sector, or the historic injustice of the racial wealth gap.