ART: stock

PQ: “In the end, it is clear that simply outlawing racist policies of the past does not necessarily fix the damage already done.”

(kicker)Margin Versus Mission

(hed)No Risk, No Reward

(sub)Community Reinvestment Act Hits The Red Line

(byline)By Christina P. O’Neill

Commercial Record Staff

If it were possible to legislate good times for all, banks wouldn’t be caught between the requirements of the Community Reinvestment Act and today’s broadened definition of “redlining,” a term with antecedents in early 20th century maps in which zones termed as high-risk lending environments were highlighted in red, as opposed the blue, yellow and green hues of more economically-sanguine districts.

Until the 1974 Equal Opportunity Credit Act, regulators had to demonstrate hard evidence of a lender’s overt and intentional discrimination against a specific socioeconomic group. But there’s been definition-creep over time. Current criteria call only for a demonstration that a bank’s lending policies have restricted credit to a protected group without good business reasons.

The remedy would seem to be simple: Banks must demonstrate to regulators that a branch is unprofitable in order to close it or sell it.

Norman H. Roos is a partner in the Hartford- and Boston-based law firm Robinson & Cole, LLP where he chairs the finance practice, a member in the Connecticut Bar Association’s Real Property Section, and an Executive Committee member of the CBA’s Consumer Law Section and Financial Institutions Section, where he is past chair. He also serves as general counsel for the Connecticut Mortgage Bankers Association.

He said that new risk-based capital requirements and liquidity coverage ratio requirements are designed to promote safety and soundness by discouraging risky investments and increasing the capital cushion banks have to endure losses attributable to non-performing loans or, more generally, adverse economic conditions.

“In the residential mortgage area, safety measures which formerly were addressed through internal underwriting practices and collateral requirements have now been subjected to QM and QRM [standards] which have been imposed by federal regulators,” he said. In a simultaneous development relating to fair lending laws, lenders must consider the “disparate impact” of their lending policies and practices, so that even absent any overt discrimination, banks face increased exposure to discrimination claims if their lending activities have a disproportionate impact on protected classes.

“If you’re trying to reach out to marginal borrowers and they happen to be members of a protected class, you may be exposed to both increased credit risk and fair lending regulatory risk,” Roos said.

Because of simultaneous increases in capital and liquidity requirements, banks must be very careful as to how they deploy their assets, Roos said. He indicated that concern with capital and liquidity positions, coupled with possible cutbacks to the GSEs, a principal source of residential loan liquidity, could result in a throwback to the early days when the secondary mortgage market was in its infancy, and banks could only lend to the extent of the assets they had to fund the loans.

**(sub)Tripping Points**

There’s a double-bind on mortgage lenders, particularly in Massachusetts, the only state in the union to have its own version of CRA rules. Banks which seek to serve marginal borrowers who are members of a protected class have exposure to allegations of discrimination.

Adverse CRA ratings can hinder not only branch closures but also branch acquisitions or expansions. The state Division of Banks said that an institution’s CRA performance is taken into account when considering applications for branches; mergers or acquisitions; ATMs; mobile electronic branches; and any other DOB approval, provided that there are no other countervailing financial safety and soundness or other policy considerations.

Massachusetts is the only state in the union with its own set of standards for CRA compliance, enacted in 1982. Public records of banks’ and state-chartered credit unions’ compliance with CRA can be found on the state’s website, though the DOB puts a disclaimer on the site that the posted rankings should not be construed as an assessment of the financial soundness of a listed bank. The site lists an exam date; banks receiving the top rating Outstanding in 2014 include Cape Cod Five and Rockland Trust.

Massachusetts is also the only state to impose CRA-like criteria for licensed mortgage lenders.

The American Bankers Association wrote earlier this month that banks focus mostly on business objectives – which need to be thoroughly documented as a defense against accusations of discriminatory lending, in light of the broadened criteria for what constitutes a failure to meet CRA standards. They also need to examine targeted marketing programs in order to make sure they are not “accidentally avoiding” areas with high concentrations of potentially-affected borrower classes. They have to make sure they’re lending to their entire market census tracts and review, before closing a branch, the details of why that branch is not performing in its community.

**(sub)Limited Beneficiaries**

Roos noted that the viability of a bank branch boils down to its return on assets. Banks must have a strong balance sheet and business plan to survive and flourish, he said.

“I am concerned about the regulatory environment, [in which] it’s easy to criticize banks and mortgage companies and other financial institutions for past failures. [We are] clearly all living with the consequences of those failures.”

“Recovery is still fragile, and the beneficiaries of recovery are limited,” Roos added. “I think we have a long way to go. Political agendas and the profusion of regulations are somewhat intertwined as well. … How restrictive should bank regulators be?” he asks. “If we take the risk out of financial industry, we won’t have a financial industry.”

*Email:* *coneill@thewarrengroup.com*