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Toward a More Performance-Driven Service Test: Strengthening Basic Banking Services under the Community Reinvestment Act

by

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Abstract

Financial services policy debates often overlook the service requirements for large banks under the Community Reinvestment Act (CRA), in part because the criteria are broad and difficult to measure. This article is based on an analysis of approximately 2,000 large bank examinations conducted over the last five years and an in-depth review of a large number of service test evaluations by federal regulators. It concludes that the test provides only minimal incentives for banks to reach out to unbanked and underserved populations in part because of inconsistent application, confusing standards, and perhaps pressure to help institutions earn satisfactory overall CRA ratings. The article proposes ten (10) reforms that would make the service test more performance based. If regulators adopt these measures in an upcoming review of CRA regulations, the service test has the potential to become a powerful tool in encouraging banks to help more working families connect to the financial mainstream, thus increasing their chances of qualifying for mortgage and other kinds of consumer credit.

I. Introduction

In the new economy, it is as important to have access to a basic bank account and mainstream financial services as it is to have access to electricity, running water, and a telephone.[1] Without bank accounts, families often pay high fees to check cashers and other "fringe bankers" to conduct basic daily financial transactions. Even more importantly, banking status has profound implications for families' long-term self-sufficiency. People with bank accounts are more than twice as likely to hold savings as are people who are unbanked, and are more likely to add to their savings on at least a monthly basis.[2] In fact, controlling for income and other factors, lower-income individuals with bank accounts are 43 percent more likely to have positive net financial assets of any kind than those who are unbanked.[3] Unbanked families are also far less likely than other households to have retirement accounts (8 percent vs. 53 percent in 1998).[4] Indeed, for more than half of the unbanked (54 percent), their only asset is their car.[5]

This is why community advocates, policymakers, banks, and banking regulators should be concerned that, despite the longest economic expansion on record during the 1990s, 10 percent of all American families—including 25 percent of African Americans and

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[1] Lawrence H. Summers, "Helping Americans to Save More," Remarks at the Choose to Save Forum (April 2, 2000), available at http://www.treas.gov/press/releases/ps524/htm (last visited Feb. 2, 2001).
[2] Research by Constance Dunham, based on a survey by the Office of the Comptroller of the Currency in Los Angeles and New York City. Cited by Ann Kim, "Taking the Poor into Account: What Banks Can Do To Better Serve Low-Income Markets," Progressive Policy Institute Policy Report, July 2001, pp. 2-3. Downloaded at www.ppionline.org, August 31, 2001.
[3] U.S. Department of the Treasury, "The First Accounts Initiative: Bringing the 'Unbanked' into the Financial Mainstream," December 16, 2000.
[4] Federal Reserve Board, Survey of Consumer Finances (1998) and calculations by the authors.
[5] Id.

Hispanics, a quarter of all families with incomes under $20,000, and nearly half of all families moving from welfare to work—have no bank accounts.[6]

In his recent book, *Savings for the Poor*, Michael Stegman detailed how technological advances and public policies—most importantly, the delivery of government benefits through electronic funds transfer (EFT) and the creation of individual development accounts (IDAs) to help lower-income families build assets—have combined to create new market opportunities for financial institutions to profitably serve unbanked and marginally banked populations.[7] Yet despite the dramatic cost-cutting potential of electronic banking and the availability of public funds for basic account and financial education programs,[8] many banks have been slow to reach out to potential new customers. A major Treasury initiative that subsidizes banks to provide low-cost Electronic Transfer Accounts for millions of unbanked federal benefit recipients, for instance, has generated only 8,100 accounts spread among 600 banks in the last two years.[9]

This article argues that an additional public policy tool, passed by the Congress in 1977 but largely overlooked in previous unbanked initiatives, has the potential to provide powerful incentives for financial institutions to improve services to lower-income families. The Community Reinvestment Act (CRA), enacted in 1977 to combat credit redlining, focuses primarily on bank lending activities in low- and moderate-income neighborhoods, and federal financial regulators grade banks on three measures of compliance: community development lending, investment, and service.

Current CRA regulations assign a bank twice as many points—a total of twelve—for an outstanding rating under the lending test as for the investment and service tests (six points each). Under the service test, regulators grade banks on providing services such as low-cost checking accounts, financial education seminars, and IDA savings programs. Despite the not insignificant weight of the service test rating—25 percent of a bank's total CRA score—its impact to date is quite uncertain. In part, this is because service test criteria cover a broad range of issues, and its performance data are not as readily available for statistical analysis as are performance data on bank lending activities. In addition, the service requirements are the easiest part of CRA examinations; only 11 banks received less than "satisfactory" ratings on the service test between 1996 and early 2001. Given the high rate of passing and the lack of performance data, it is perhaps not surprising that banks, examiners, policymakers, and

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[6] Id.

[7] Michael A. Stegman, *Savings for the Poor: The Hidden Benefits of Electronic Banking*, Washington, D.C., Brookings Press, 1999. EFT creates potential economies of scale because it depends on millions of unbanked benefit recipients opening accounts to receive direct deposits. IDA programs—which match families' savings with government or private money to help accountholders purchase a home, pay for education, or start a business—provide a steady source of deposits for financial institutions while participants build their assets.

[8] To facilitate EFT, the Treasury Department has undertaken several initiatives to stimulate the development of new, low-cost banking products that rely on cost-reducing technologies. The First Accounts Act of 2000 (H.R. 4490) authorizes $30 million to the Department of the Treasury to test a program, in fiscal 2001, to broaden access to banking services in lower-income communities. The Assets for Independence Act, Public Law 105-285, authorizes $125 million in federal funds to support local IDA programs over a five-year period.

[9] *"Federal ETA Effort Off to a Slow Start, but Interest Building," ATM & Debit News, Mar. 29, 2001, at 1.*

community advocates have given the service test relatively little attention in either general CRA debates or in initiatives focusing on the unbanked.[10]

To assess the service test, we analyzed scoring patterns on almost two thousand CRA examinations conducted in the last five years and conducted in-depth reviews of more than 100 examination reports. Our research suggests that confusing standards, inconsistent examinations, and a lack of quantitative information generally hampers administration of the current CRA service test. Our statistical analysis also suggests that pressure to help institutions earn satisfactory overall CRA ratings may impact service test scores for borderline banks. And while bank programs that provide accounts for unbanked populations, promote savings and asset accumulation, and educate consumers about homeownership and the dangers of predatory financial services can receive limited CRA credit, many examinations pay only cursory attention to such initiatives.

As federal regulators embark on a comprehensive review of CRA regulations in 2002 to determine the effectiveness, consistency, and compliance burden of current examination standards,[11] our research suggests that they should strengthen service test for two reasons. First, if examiners do not apply the service test as rigorously as CRA lending and investment requirements, its 25 percent weight effectively dilutes the strength of the other standards. Second, and even more importantly, a revamped service test could reinforce and leverage the positive impacts of other federal policies targeting the unbanked. Creating stronger incentives for banks to reach out to underserved populations is consistent with the statutory purposes of the CRA, because basic accounts, savings, and financial education are critical for helping families achieve financial stability and prepare themselves to qualify for consumer, home, and business credit over the long run. Just as CRA lending requirements have helped banks recognize the market potential for home loans in low- and moderate-income areas,[12] a strengthened service test would facilitate the development of new markets, products, and technologies to help banks provide profitable basic banking services for underserved populations.

We offer here ten proposals for strengthening the service test. The remainder of this article has five parts and two appendices. Part II discusses how the service test fits into the larger regulatory framework of the Community Reinvestment Act. Next, we discuss the

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[10] The idea to analyze the service test was generated while Michael Stegman was testifying before the U.S. House Committee on Banking and Financial Services in June 2000. Ranking member John J. LaFalce (D-NY) suggested that the Center for Community Capitalism develop a service test scorecard, arguing that performance-based standards for the service test would bolster recent unbanked initiatives as well as benefit "financial institutions, banking regulators and middle- and lower-income consumers by providing clearer criteria for achieving the purposes of the CRA." Letter from John J. LaFalce, to Dr. Michael A. Stegman, August 11, 2000.

[11] See Community Reinvestment Act Regulations, Joint Advance Notice of Proposed Rulemaking, 66 Fed. Reg. 37,602, 37,603 (July 19, 2001).

[12] "Between 1993 and 1998, depository institutions covered by the CRA and their affiliates made a total of $467 billion in mortgage loans to low- and moderate-income borrowers, and borrowers in low- and moderate-income neighborhoods." National Congress for Community Economic Development, NCCED Policy & Legislation, "Treasury Reports to Congress on CRA's Impact," at www.ncced.org/policy/articles/2000/treasurycrainfo.html. Last downloaded 11/23/00. For information on the profitability of CRA lending, see Board of Governors of the Federal Reserve System, "The Performance and Profitability of CRA-Related Lending, Report to the Congress Pursuant to Section 713 of the Gramm-Leach-Bliley Act of 1999, Washington, D.C., July 17 2000, p. ii.

individual components of the service test and how CRA ratings are determined. Part IV analyzes scoring patterns on nearly two thousand CRA examinations of large banks to compare banks' performance on service to CRA lending and investment requirements. The results suggest that grade inflation may be a problem, particularly when banks are in need of a higher service test score so that they can get enough points to earn an overall CRA rating of satisfactory. Part V summarizes an in-depth qualitative review of more than 100 examinations, concluding that a number of problems have undermined the rigor of the service test in general and the incentives to provide services to the unbanked in particular. We discuss our recommendations for strengthening and improving the service test in Part VI. If adopted, these proposals would make the service test more susceptible to quantitative evaluation and less susceptible to overly-generous grading—intentional or not—by federal regulators, while also providing greater incentives to banks to meet the financial services needs of low- and moderate-income populations and communities.

II. The Legal Foundation for the CRA Service Test

Because the Community Reinvestment Act focuses on the provision of credit to low- and moderate-income (LMI) communities, the extent of federal regulators' authority to address the provision of financial services has been the subject of some debate. Some financial institutions have argued that CRA examinations should focus exclusively on lending activities without addressing bank services or equity investments. On the other side, some consumer advocates have read the act broadly to allow extensive examinations of deposit services and have argued that the CRA should be used to mandate the provision of low-cost accounts and other non-credit services. Before considering proposals to strengthen the current service test, then, it is helpful to analyze the legal foundation for CRA services requirements and limitations on federal regulators' authority under the statute.

When it passed the Community Reinvestment Act in 1977, Congress was addressing complaints that banks and thrifts were systematically "redlining" low- and moderate-income areas by refusing to make loans there regardless of the qualifications of individual borrowers. Echoing language in other statutes concerning deposit insurance, bank charters, and bank mergers, the act requires that federally insured deposit facilities "serve the convenience and needs of the communities in which they are chartered to do business."[13] The CRA defines the "convenience and needs" of communities to include credit services as well as deposit services, and concludes that financial institutions have a continuing and affirmative obligation to help meet those credit needs.[14] Although some of the statute's language is quite broad, the act authorizes examinations specifically to assess each institution's record of meeting "the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with . . . safe and sound operation[s]." Federal regulators take banks' performance

[13] 12 U.S.C. § 2901(a)(1); General Accounting Office, *Community Reinvestment Act: Challenges Remain to Successfully Implement CRA* 18 (Nov. 1995).
[14] 12 U.S.C. § 2901(a)(2), (a)(3).

into account when evaluating applications by the institution for additional deposit facilities, mergers, and other expansions.[15]

While the CRA does not explicitly direct regulators to consider a financial institution's record of meeting deposit needs as distinct from meeting credit needs, federal agencies have always included services, including bank branches, as an element of CRA examinations. Congress has not protested.[16] The four agencies charged with implementing the CRA—the Office of the Comptroller of the Currency (OCC), the Federal Reserve System (FED), the Office of Thrift Supervision (OTS), and the Federal Deposit Insurance Corporation (FDIC)—have separate but virtually identical CRA regulations.[17] Originally, CRA examinations contained twelve "assessment factors;" the opening and closing of branches and the provision of retail services were combined into one factor. In the mid 1990s, federal regulators created three-component examinations for large retail financial institutions: lending, investment, and service. Regulators included the service test to focus attention on the importance of full-service banking relationships in helping LMI customers access credit:

> In the CRA, Congress found that regulated financial institutions are required by law to demonstrate that they serve the convenience and needs of their communities and that "the convenience and needs of communities include the need for credit services as well as deposit services." (See 12 U.S.C. 2901.) The CRA focuses, however, on an institution's effort to help meet the credit needs of its community or communities.
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> Branch availability in a community is critical to the availability of credit, as well as deposit, services. . . .Moreover, accessible branches are critical to the development of the full-service banking relationships that facilitate participation in the credit system.[18]

The Rulemaking Process

Over the course of the two-year rulemaking process, regulators increased the scope of the service test in response to criticisms that branch location does not guarantee that banks are effectively serving LMI customers. Regulators acknowledged that a system of "evaluations based on the mere presence of brick and mortar facilities is not sufficient....Under the revised

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[15] *Id.* § 2903(a) Specifically, regulators consider CRA performance when banks and thrifts apply to establish branches, merge with, or acquire other institutions, and to become bank holding companies. While regulators only rarely deny such applications based on CRA concerns, community groups can slow down the approval process significantly with CRA protests. These delays cost the applicants money and can even scuttle merger plans. As part of the redrafting of CRA regulations from 1993 to 1995, the regulatory agencies proposed CRA enforcement actions against low-performing banks, but the Department of Justice ruled in 1994 that they did not have statutory authority. Joint Final Rule, 60 Fed. Reg. 22,155, at 22,158 (May 4, 1995).

[16] The statute itself does not create substantive standards for determining whether banks' lending activities are adequate, so all standards are set by regulation. Congress has amended the CRA several times during the 1990s—most recently in the Gramm-Leach-Bliley Act of 1999 15 U.S.C. §6801, but made no changes concerning the service test.

[17] See 12 C.F.R. Parts 25 (OCC), 228 (FED), 345 (FDIC), 563e (OTS). For convenience, references to the Code of Federal Regulations in this article cite the OCC's regulations.

[18] Joint Notice of Proposed Rulemaking, 58 Fed. Reg. 67,466, at 67,471 (Dec. 21, 1993).

proposal, equal weight would be given to the actual services provided to [LMI] geographies."[19] While the original service test would have been based almost entirely on the percentage of branches that were readily accessible to LMI areas,[20] the final service test addressed a range of delivery channels as well as tailoring retail services to meet local needs and providing financial literacy programs and other community development services. Regulators also increased the weight of the service test to constitute 25 percent of large banks' overall CRA ratings.[21]

However, while strengthening service requirements, the banking agencies rejected calls by community advocates to give deposit accounts and other basic banking services equal weight with lending under the CRA. Regulators refused to measure the effectiveness of service performance based on deposit growth,[22] concluding that such a "measurement is not clearly related to helping meet the credit needs of the community and could necessitate burdensome coding of deposit accounts on a geographic basis."[23] The agencies also refused to mandate that banks provide low-cost checking accounts. They viewed such a requirement as inconsistent with the CRA's general emphasis on giving financial institutions "substantial leeway to determine the specific policies and programs that help meet credit needs in their communities."[24] Finally, the agencies rejected calls to require financial institutions to earn at least a "low satisfactory" score on the service test in order to receive a "satisfactory" or "outstanding" overall CRA rating, concluding that "because the CRA's focus is on helping to meet a community's credit needs, it would be inappropriate to impose this requirement."[25]

Thus, unless Congress amends the CRA statute to focus directly on ensuring that banks meet community deposit needs, federal regulators' authority to address accounts, check cashing, savings programs, and financial education under the CRA depends on how strongly such products and services facilitate lending activities. Because low-cost accounts were widely available when Congress passed the CRA in 1977, being unbanked may not have been seen as a major obstacle to accessing more sophisticated financial services. However, recent research indicates that a strong link exists between account ownership and both savings outcomes and access to bank credit.

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[19] Joint Notice of Proposed Rulemaking, 59 Fed. Reg. 41,232, at 51,239 (Oct. 7, 1994).

[20] Scores could have been adjusted based on a range of qualitative factors. These included an institution's record of branch closings and openings, significant differences in services offered to LMI areas and individuals, and strong records of providing or supporting low-cost check cashing and other "services that promote credit availability for low- and moderate-income areas and individuals." Joint Notice of Proposed Rulemaking, 58 Fed. Reg. 67,466, at 67,471 (Dec. 21, 1993).

[21] Under the initial proposal in 1993, an institution's service test score would only have affected its CRA rating if the service score was "outstanding" (in which case the composite rating would be increased one level, for example from "needs to improve" to "satisfactory") or "substantial non-compliance" (in which case the composite rating would be decreased one level). Joint Notice of Proposed Rulemaking, 58 Fed. Reg. 67,466, at 67,471. The final regulation does not specify how service test ratings impact banks' overall CRA classifications, but federal agencies use a scoring system in which six of twenty-four potential points on large bank CRA examinations come from the service test. See Part IV.

[22] Joint Final Rule, 60 Fed. Reg. 22,156, at 22,167 (May 4, 1995).

[23] *Id.*

[24] *Id.*

[25] *Id.* at 22170

The Importance of being "Banked"

Our analysis of data from the most recent Survey of Consumer Finances indicates that lower-income families with checking, savings, or money market accounts are six times as likely as their unbanked peers to have credit cards and are more than twice as likely to have a home mortgage (see table 1). Moreover, "banked" lower-income families are also far more likely than unbanked families to have assets such as certificates of deposit, individual retirement accounts, and life insurance. In fact, the percentage of families owning certificates of deposits is actually higher for lower-income families than for U.S. families as a whole. Because of their greater financial stability, banked lower-income families thus have a better chance of qualifying for additional credit over time.

Table 1

Ownership of Financial Products by All Families & Lower-Income Families, 1998*

Product	% All U.S. Families	% All Lower-Income Families	% Lower-income with accounts**	% Lower-income w/o accounts**
Credit card(s)	72.5	50.2	60.5	10.8
Mortgage	43.1	18.1	20.5	8.9
Cert. of Deposit	15.3	14.1	17.2	1.9
IRA/Keogh	28.3	11.9	14.6	1.4
Cash life insurance	29.6	19.2	21.2	11.5

Source: Federal Reserve Board, 1998 Survey of Consumer Finances, and authors' calculations

* Lower-income is defined as 80 percent of regional income.

** Transaction accounts include checking, money market transaction accounts, and savings accounts.

Furthermore, the greatest opportunities for expanding mainstream banks' home mortgage lending business lie in the rapidly growing minority market, where homeownership rates remain 20 percentage points below the national rate.[26] To prosper in our increasingly diverse country, banks and thrifts must penetrate the large market of African American and Hispanic renters with incomes under $40,000. However, institutions should be aware that more than 40 percent of this market segment are unbanked and far removed from the credit mainstream.[27] Thus, opening accounts and providing other basic services is an important first step in developing relationships with nearly one out of every two potential homebuyers in this critical growth market. Regulators are increasingly making this point to their own staff and to the institutions they supervise. A recent example is the advice given by Ellen Seidman, director of the Office of Thrift Supervision, to a gathering of thrifts. After noting that "more than 20 years after CRA was enacted, we still have communities that are not adequately

[26] In the second quarter of 2001, while the overall homeownership rate soared to 67.7 percent, fewer than half of African-American (48.6 percent) and Hispanic families (46.1 percent) were homeowners. "Minority Homeownership Rate Sets New All-Time High, Nation's Rate Ties Record," Mortgage Bankers Association of America, July 27, 2001, downloaded at http://wwwmbaqa.org/industry/news/01/0727c.html.

[27] Federal Reserve Board, Survey of Consumer Finances (1998) and authors calculations.

served by insured depository institutions," she urged her audience not to "sit on the sidelines," and to go after this untapped market:[28]

> Immigrant and native-born American communities have residents who newly need the range of services of mainstream financial institutions…these markets are full of creditworthy borrowers and profitable depositors and users of other financial services….By working with community groups or marketing consultants knowledgeable about how to reach these new customers, traditional institutions may well find a gold mine, and will almost certainly find good new business.[29]

III. A Primer on the Service Test

The creation of the service test in 1995 was part of a larger overhaul of CRA regulations designed to address widespread complaints that examination standards were vague, burdensome, and left too much room for inconsistency among examiners. In response to a request by President Bill Clinton to "replace paperwork and uncertainty with greater performance, clarity, and objectivity,"[30] federal regulators created separate standards for large, small, and wholesale or limited purpose financial institutions. While the original CRA regulations had focused on bank marketing efforts, the role played by corporate leaders, and other "process" based issues, the new rules attempted direct evaluations of banks' lending, investment, and service activities in LMI communities.[31]

The most rigorous and comprehensive requirements under the 1995 regulations apply to "large" banks and thrifts, by definition those that have at least $250 million in assets or that are owned by financial holding companies with at least $1 billion in assets.[32] Of the three component tests applied to large banks, however, the service test is the most eclectic and the least clearly defined. The lending test involves extensive quantitative analysis of bank loans as to number and amount, geographic distribution, and borrower characteristics as well as consideration of community development lending and innovative or flexible lending

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[28] "Puzzling Through: Approaching Alternative Credit Responsibly," Remarks by Ellen Seidman, Director, Office of Thrift Supervision, before the Interagency Conference on CRA, San Francisco, Ca., April 17, 2000, p. 2. Downloaded at http://www.ots.treas.gov/docs/87075.pdf, September 3, 2001.

[29] *Id.*

[30] Joint Notice of Proposed Rulemaking, 58 Fed. Reg. 67,466, at 67,467.

[31] Federal agencies took a process-based approach in the late 1970s to address congressional concerns that the statute not be used to make credit allocation decisions. General Accounting Office, supra, at 25-26. Yet while the 1995 regulations are clearly more performance-based, regulators struggled to balance quantitative and qualitative elements. In 1993 regulators proposed a largely objective, quantitative set of criteria , but commenters argued passionately that the criteria did not sufficiently account for differences in local communities and financial institutions. In 1994 regulators adopted a broader approach that they admitted would increase, rather than reduce, the number of judgments that examiners would be required to make. "[A] CRA evaluation system eliminating all examiner judgment would not be desirable, even if it were achievable," the agencies concluded. Joint Notice of Proposed Rulemaking, 59 Fed. Reg. 51,232, at 51,234 (Oct. 7, 1994).

[32] Small institutions are examined primarily on lending activities, while limited purpose and wholesale banks are evaluated based on community development lending, investments, and services. Institutions of any type can choose to be governed by "strategic plans" that they design themselves under supervision by regulators. However, only a few dozen institutions have chosen this option.

practices.[33] The investment test focuses primarily on the amount of qualified community development investments, while also crediting innovation, complexity, and responsiveness to community needs.[34]

Retail Banking Services

In contrast, the service test covers several different subjects and includes a broad mix of both quantitative and qualitative criteria. First, examiners consider the "availability and effectiveness" of a bank's systems for delivering retail banking services, specifically:

- *The current distribution of branches among low-, moderate-, middle-, and upper-income neighborhoods*. This is the most quantitative element of the service test, as examiners generally compare the percentage of LMI branches to each assessment area's demographic makeup to determine whether accessibility is adequate. Federal regulators have emphasized that the CRA regulations do not require institutions to expand their branch networks or to operate unprofitable branches.[35]

- *The bank's record of opening and closing branches, particularly those serving low- and moderate-income (LMI) neighborhoods and individuals*. Specifically, examiners look at the record of opening and closing branch offices since the institution's previous CRA examination. Federal examination procedures direct them to evaluate information indicating whether the changes have had a positive or negative effect on LMI neighborhoods and individuals but do not specify the type and source of information to be considered.[36]

- *The availability and effectiveness of alternative delivery systems serving LMI neighborhoods and individuals*. Federal agencies have emphasized that ATMs, telephone banking, on-line banking, and other alternative delivery systems are to be considered only to the extent that they effectively provide needed services to LMI areas and individuals.[37] Debit cards are not by themselves considered to be an alternative system, but may be part of a comprehensive electronic banking delivery system.[38]

- *The range and degree of tailoring of services provided in low-, moderate-, middle-, and upper-income neighborhoods*. Examiners must obtain an explanation from the institution if they find any "material differences" in the hours of operation and/or services available at branches in different census tracts. They must also

[33] 12 C.F.R. §§ 25.22, .23.
[34] *Id.*
[35] Federal Financial Institutions Examination Council, Interagency Questions and Answers Regarding Community Reinvestment, § .24(d)-1, 65 Fed. Reg. 25,088, 25,103 (Apr. 28, 2000) [hereinafter FFIEC Q&A].
[36] Federal Financial Institutions Examination Council, Community Reinvestment Act Examination Procedures for Large Retail Institutions 11 (Apr. 1997) [hereinafter FFIEC Large Bank Examinations].
[37] FFIEC Q&A, *supra*, § .24(d)(3)-1, 65 Fed. Reg. at 25,104.
[38] *Id.* § .24(d)(3)-2

consider the degree to which services are tailored to the convenience and needs of each neighborhood.[39]

Community Development Services

The second prong of the service test focuses on large banks' "community development services," which are defined as activities relating to the provision of financial services that have community development as their primary purpose. Community development services should not have been considered under the retail banking services prong.[40] Examples of community development services include providing low-cost deposit accounts, technical assistance to housing and development organizations, credit counseling and other financial services education, Individual Development Accounts (IDAs) and other savings initiatives, and electronic benefits transfer (EBT) programs.[41] For each such activity, examiners must determine:

- *The extent of community development services provided*. Federal examination procedures also direct examiners to determine the degree of customers' use of such services.[42]

- *The innovativeness and responsiveness of the services*. Innovation includes a determination of whether the activities serve LMI populations in new ways or serve groups of new customers.[43] Responsiveness is defined as "the degree to which [the activities] serve low- or moderate-income areas or individuals and their responsiveness to available opportunities for community development services."[44]

Examiners assess all of these service test criteria within a "performance context" consisting of the community's demographics and needs; the bank's business strategy, product offerings, institutional capacity and constraints, safety and soundness limitations, past performance, and public file; and other relevant information about the institution and the communities in which it operates.[45]

The Grading System

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[39] FFIEC Large Bank Examinations, *supra*, at 11.
[40] 12 C.F.R. § 25.12(j).
[41] FFIEC Q&A, supra, §§ .12(j) & 563e.12(i)-3, 65 Fed. Reg. at 25,096; OCC Interpretive Letter 728, at 3 n.2 (June 1996). Electronic benefits transfer (EBT) involves use of a debit card system to provide access to Food Stamps, Temporary Assistance to Needy Families, and other state-run government benefit programs. Unlike EFT, which uses direct deposit to transfer Social Security and other federal benefits directly to recipients' own accounts, EBT recipients simply use a plastic card at ATMs and point-of-sale terminals to draw benefits from state accounts. Thus, while the program requires training to use electronic banking services, EBT recipients may remain unbanked. Financial institutions may receive CRA credit if they waive or reduce fees for EBT participants or otherwise work to decrease costs and improve access. FFIEC Q&A, supra, §§ .12(j) & 563e.12(i)-3, 65 Fed. Reg. at 25,096; OCC Interpretive Letter 728, at 3 n.2 (June 1996).
[42] FFIEC Large Bank Examinations, *supra*, at 12.
[43] *Id*.
[44] *Id.*
[45] 12 C.F.R. § 25.21(b).

Like the lending and investment tests, service test ratings are divided into five categories: outstanding, high satisfactory, low satisfactory, needs to improve, and substantial noncompliance. For all three components of the test, the definitions for each ratings category are quite vague, even for largely quantitative criteria such as the distribution of bank branches in LMI areas or the extent of qualified community development investments. On the service test, for example, a bank receives an "outstanding" rating if its examiner generally judges it to:

- Have delivery systems that are "readily accessible" to geographies and individuals of different income levels;
- Have a record of opening and closing branches that has "improved the accessibility" of its delivery system, particularly for LMI neighborhoods and individuals, to the extent that changes have been made;
- Provide services that are "tailored to the convenience and needs" of its assessment areas, particularly for LMI neighborhoods and individuals; and
- Be a "leader" in providing community development services.[46]

However, none of the phrases in quotes are defined in any regulatory materials. Moreover, a bank's performance need not actually meet all of the criteria for a particular ratings category; rather, exceptionally strong performance in one area may compensate for weak performance in another as long as the overall performance is consistent with safe and sound practices and with the appropriate rating "profile."[47] Thus, the scoring system injects a subjective element into even objective, statistical CRA criteria.

In contrast to the individual component tests, the computation of banks' overall CRA ratings depends on a mathematical formula. Once a large bank has received its lending, investment, and service test scores, examiners use a point system to determine whether the institution receives an overall CRA rating of outstanding, satisfactory, needs to improve, or substantial noncompliance. The lending test is worth twice as much as the other exams, so that banks can earn a maximum of twelve points on lending and six points each on investment and service. Credit activities are further emphasized by requiring that institutions earn at least a "low satisfactory" (worth 6 points) on the lending test in addition to receiving at least eleven total points in order to receive a satisfactory CRA rating overall (see table 2).

[46] 12 C.F.R. pt. 25, app. A(b)(3)(i).
[47] *Id.* app. A(a)(2).

Table 2

Calculations of Overall CRA Ratings on Large Bank Examinations

Component Test Scores				*Overall Ratings*	
Rating	Lending	Invest.	Service	Rating	Points needed
Outstanding	12	6	6	Outstanding	20-24
H. Satisfactory	9	4	4	Satisfactory*	11-19*
L. Satisfactory	6	3	3	Needs to Imp.	5-10
Needs to Imp.	3	1	1	Sub. Noncomp.	0-4
Sub. Noncomp.	0	0	0		

Source: FFIEC, CRA Questions and Answers, 65 Fed. Reg. 25,088, 25,107 (Apr. 28, 2000)
* Institutions must also earn at least a low satisfactory on lending to receive a satisfactory overall.

IV. The Determinants of CRA Scores

Although research on CRA lending activities is extensive,[48] we could find no studies on the service test in particular and only two small, early studies on large bank examination results in general.[49] The fact that federal regulators do not track statistics on large banks' lending, investment, and service test results, but instead include only banks' overall CRA ratings in the database maintained by the Federal Financial Institutions Examination Council (FFIEC), hampers such research. Moreover, although public CRA and Home Mortgage Disclosure Act (HMDA) data allow detailed analyses of bank lending activities, statistics on branch and deposit account distribution are not publicly available except to the extent reported in CRA examination reports for individual institutions.

Compiling a CRA Database

Accordingly, to analyze scoring patterns on the service test and other components of large bank examinations, the Center for Community Capitalism created its own database by compiling the results from nearly two thousand CRA Public Evaluation reports released during the first five years under the new CRA regulations, from January 1996 through January 2001 (see Appendix A for details, including a discussion of the large number of errors we

[48] For an extensive survey of CRA research, see *Susan White Haag, Community Reinvestment and Cities: A Literature Review of CRA's Impact and Future*, App. A (Brookings Institution Discussion Paper Mar. 2000). *See also* Glenn B. Canner & Wayne Passmore, The Community Reinvestment Act and the Profitability of Mortgage-Oriented Banks (Federal Reserve Board Finance & Economics Discussion Series 1997-7); Griffith L. Garwood & Dolores S. Smith, The Community Reinvestment Act: Evolution and Current Issues, 78 *Fed. Res. Bull.* 251 (1993); Larry Meeker & Forest Myers, Community Reinvestment Act Lending: Is It Profitable?, *J. Fin. Indust. Perspectives*, Dec. 1996.

[49] *See Kenneth H. Thomas, The CRA Handbook* 355-419 (1998); Daniel Immergluck, Is CRA Reform for Real? Analyzing the Ratings of Large Banks Opting for Evaluation Under the New CRA Regulations 3 (Woodstock Institute Working Paper, Sept. 1997). Both studies focused on institutions that were evaluated under the new standards in 1996 and the first half of 1997, before the large bank examination procedures became mandatory.

found in the FFIEC database). We believe that the analysis of component scores presented below may be the first full-scale study of large bank CRA examination results ever conducted.

In general, we found that large banks have extremely high passage rates on CRA examinations, with more than 98 percent of institutions receiving an overall rating of satisfactory or outstanding. This is consistent with passage rates for all financial institutions under the old CRA standards, which climbed above 95 percent in the mid-1990s.[50] Community activists have long interpreted such statistics as evidence of grade inflation, arguing that passage rates should not be 90 percent or higher given that minority and LMI homebuyers and businesses still struggle to gain access to credit.[51]

When we broke down the results by component test, a more complex pattern emerged. Banks tend to earn the highest number of "outstanding" and "high satisfactory" ratings on the lending test, but the service test is the easiest of the three component tests to pass, possible with at least a "low satisfactory" rating. Specifically, only 15 examinations of 11 banks have resulted in a rating of "needs to improve" on the service test in the past five years, and no bank has ever earned a "substantial noncompliance" rating on service activities.[52] This failure rate is slightly better than for lending, where about 1 percent of institutions have earned "needs to improve" or "substantial noncompliance" ratings since 1996, and significantly better than the 17.5 percent failure rate on the investment test. These results appear generally similar to the trends found in the earlier studies focusing on banks examined in 1996 and early 1997.[53]

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[50] *See* Immergluck, *supra*, at 1-3; Banks' CRA ratings were not released publicly until Congress amended the act in 1989 in response to pressure from community advocates. In 1990, approximately 87 percent of institutions received satisfactory or outstanding overall ratings. By 1996, as the new regulations were being phased in, passage rates reached 98 percent. Immergluck, supra, at 1-3;

[51] Critics also note that CRA ratings began to improve in the early 1990s, at a time when LMI lending rates were actually declining. *See* Immergluck, *supra*, at 1-3. *See* also CRA Report Card (An "A" to "F" bell curve guide for evaluating a bank's CRA performance), prepared by the Greenlining Institute, October 25, 2000. Using the nine separate subratings contained in CRA exams, the Greenlining Institute created a report card for institutions with overall grades ranging from A to F. "If a financial institution received an overall 'outstanding' rating and an 'outstanding' in each of the three test areas, it received an 'A.' If it received only two 'Outstandings,' it received an 'A-.' If it received an overall 'Satisfactory' but 'High Satisfactories' in all three areas, it received a 'B.' However, if it received only 'Low Satisfactories' in each area, it received a 'C-' and so on." (Section 1, p. 1-2.)

[52] About half of the institutions receiving "needs to improve" ratings were extremely specialized facilities that offered few if any retail services to the general public but had not been classified as limited purpose or wholesale banks. The others were simply judged by examiners to be substandard, although other institutions with similar performance had been rated as "low satisfactory."

[53] Immergluck analyzed scoring patterns on the three component tests for 95 institutions. He found that performance was highest on the lending test, with 21 percent of institutions receiving an "outstanding" rating and another 52 percent receiving "high satisfactory." The service test rated second, with 19 percent "outstanding" and 42 percent "high satisfactory." However, many banks appeared to struggle with the remaining investment component, where only 20 percent of institutions received an "outstanding" or "high satisfactory" and 18 percent "failed" the test with a "needs to improve" or "substantial noncompliance" score. Immergluck, *supra* note 134, at 13-16. In his study of the thirty-one examinations, Thomas reported that 55 percent of institutions scored "outstanding" or "high satisfactory" on lending, 52 percent on service, and 29 percent on investment. *Thomas, supra* note 37, at 362.

In contrast to the results presented in this paper, however, Immergluck found that banks regulated by the OCC tended to receive higher ratings on all of the component tests. On the service test, for instance, 31 percent of OCC institutions received "outstanding" ratings, compared with 11 percent for FDIC banks, 7 percent for the

Our comparison of the distribution of overall CRA ratings by regulator (see table 3) suggested that not all agencies use similar criteria in awarding scores. For instance, while all four agencies are very unlikely to give out "needs improvement" ratings, the Office of the Comptroller of the Currency (OCC) tends to award fewer (13 percent, vs. 17 percent overall) outstanding scores than the others.

Table 3: Overall CRA Ratings, by Regulator, 1996-2001

Regulator	Outstanding	Satisfactory	Needs Improvement	Noncompliance	Total
Overall Rating	16.6%	81.8%	1.5%	0.1%	100%
Office of the Comptroller of the Currency	12.5%	86.5%	1.0%	0.0%	100%
Federal Reserve Board	18.7%	80.1%	1.3%	0.0%	100%
Federal Deposit Insurance Corporation	16.7%	81.3%	1.9%	0.1%	100%
Office of Thrift Supervision	20.0%	78.3%	1.7%	0.0%	100%

N = 1,954

Source: Center for Community Capitalism, CRA Database, 2001

Analyzing Component Test Scores

The same pattern emerges for the component tests. In general, the OCC rates banks lower than does the FED, the FDIC, and the OTS. While the latter three regulators awarded an "outstanding" rating on the lending test to around a fifth of all banks they examined, this was true for just 13 percent of all OCC examinations (see table 4.)

Table 4: CRA Lending Test Ratings, by Regulator, 1996-2001

Regulator	Outstanding	High Satisfactory	Low Satisfactory	Needs Improvement	Noncompliance	Total
Overall	18.0%	57.3%	23.8%	0.9%	0.1%	100%
OCC	13.3%	59.9%	26.2%	0.6%	0.0%	100%
FED	21.2%	58.9%	19.3%	0.6%	0.0%	100%
FDIC	18.2%	58.9%	21.8%	1.0%	0.1%	100%
OTS	21.2%	48.4%	29.3%	1.2%	0.0%	100%

N = 1,954

Source: Center for Community Capitalism, CRA Database, 2001

A similar pattern exists with respect to service test scores (see table 5): where just 10 percent of all OCC service test scores were "outstanding," this was true for 15 percent to 20 percent of service test scores levied by the other three regulators. As with the lending test, none of the agencies gave failing grades ("needs improvement" or "noncompliance") to more than 2 percent of the financial institutions they examined.

Federal Reserve, and 13 percent for the OTS. Immergluck attributed this pattern in part to the fact that the OCC-regulated banks tended to be some of the agency's best CRA performers, while many of the OTS and FDIC large bank volunteers had historically performed below average. Immergluck, *supra* note 134, at 13-16.

Table 5: CRA Service Test Ratings, by Regulator, 1996-2001

Regulator	Outstanding	High Satisfactory	Low Satisfactory	Needs Improvement	Noncompliance	Total
Overall	16.5%	52.7%	30.0%	0.7%	0.0%	100%
OCC	10.4%	48.4%	41.0%	0.2%	0.0%	100%
FED	14.6%	65.1%	19.9%	0.3%	0.0%	100%
FDIC	20.1%	49.9%	28.8%	1.2%	0.0%	100%
OTS	18.6%	53.9%	27.0%	0.6%	0.0%	100%

N = 1,954

Source: Center for Community Capitalism, CRA Database, 2001

This pattern does not carry over to the investment test, where a much larger proportion of banks examined by each of the regulators received marginal or failing grades (see table 6). There is little difference among the agencies in their distribution of high scores, with the four regulators awarding "outstanding" scores to roughly 10 percent of the institutions they examined and "high satisfactory" scores to another 20 percent or so. Bigger differences can be found at the low end—specifically, in the "low satisfactory" and "needs improvement" scores.

Table 6: CRA Investment Test Ratings, by Regulator, 1996-2001

Regulator	Outstanding	High Satisfactory	Low Satisfactory	Needs Improvement	Noncompliance	Total
Overall	9.8%	20.5%	52.3%	16.0%	1.5%	100%
OCC	9.8%	20.2%	56.8%	12.1%	1.3%	100%
FED	10.6%	24.0%	51.1%	14.0%	0.3%	100%
FDIC	10.0%	19.2%	45.4%	22.8%	2.6%	100%
OTS	8.4%	20.6%	63.2%	7.5%	0.3%	100%

N = 1,954

Source: Center for Community Capitalism, CRA Database, 2001

Do Scores Differ Systematically Across Regulators?

It is possible that these observed differences in agency distributions of CRA scores may not be what they seem, because the banks examined by the various agencies could differ in systematic ways. For example, the size distribution of the banks examined by each agency differs substantially (see table 7): the average bank examined by the FDIC has $1.1 billion in assets, while the average bank examined by the OCC is almost four times larger, with more than $4.1 billion in assets.

Table 7: Distribution of Bank Assets*, By Regulator, 1996-2001

Regulator	Median	Mean
Overall	$512	$2,353
Office of the Comptroller of the Currency	$500	$4,169
Federal Reserve Board	$503	$3,111
Federal Deposit Insurance Corporation	$492	$1,152
Office of Thrift Supervision	$595	$1,925

* In millions of dollars
N = 1,954
Source: Center for Community Capitalism, CRA Database, 2001

A second potentially confounding factor is the timing of the exam (see table 8). Looking at the average amount of elapsed time in months from July 1997, when the new regulations took effect, to the initial CRA exam under the new regulations, we found the overall mean to be 41 months.[54] The average FDIC exam occurred about four months later, while the average FED examination took place about four months earlier, in 37 months after the new regulations took effect.

There are also differences in the regional[55] distribution of banks examined by the four regulating agencies (see table 9). For instance, banks evaluated by the FDIC are more likely to be located on the East coast (38 percent), while those examined by the FED and the OCC tend to be based in the Midwest (44 and 45 percent, respectively). Institutions examined by OTS are more than three times more likely to be based in the Pacific region as are those examined by the OCC.

Table 8: Timing of CRA Exam*, By Regulator, 1996-2001

Regulator	Mean Number of Months
Overall	41.4
Office of the Comptroller of the Currency	38.3
Federal Reserve Board	35.7
Federal Deposit Insurance Corporation	45.5
Office of Thrift Supervision	41.1

*Average number of months between July, 1997 and date of exam.
N = 1,512
Source: Center for Community Capitalism, CRA Database, 2001

[54] Change in exam scores for the subset of banks with multiple tests is discussed in Appendix B.
[55] The East Coast region includes: CT, DE, DC, ME, MD, MA, NH, NJ, NY, PA, RI, VT, and VA. The South region includes: AL, AR, FL, GA, KY, LA, MS, NC, SC, TN, and PR. The Midwest region includes: IL, IN, IA, KS, MI, MN, MO, NE, OH, ND, SD, WV, and WI. The West region includes: AZ, CO, ID, MT, NV, NM, OK, TX, UT, WY. Finally, the Pacific region consists of: CA, AK, AS, FM, GU, HI, OR, PW, and WA.

Table 9: Geographic Distribution of Banks, by CRA Evaluator, 1996-2001

Region	Overall	Agency OCC	FED	FDIC	OTS
East coast	31.2%	25.2%	23.4%	37.6%	31.9%
South	14.6%	14.4%	13.4%	15.1%	15.1%
Midwest	34.2%	43.9%	44.7%	25.6%	31.0%
Mountain west	9.1%	11.6%	9.4%	9.3%	4.6%
Pacific	10.9%	5.0%	9.1%	12.4%	17.4%
Total:	**100%**	**100%**	**100%**	**100%**	**100%**

N = 1,954

Source: Center for Community Capitalism, CRA Database, 2001

Because of these potentially confounding factors, we analyze CRA scores using a multivariate statistical technique known as ordered logistic regression.[56] The model we specify measures the likelihood that a bank's service test rating will receive a higher CRA grade given a one unit change in a given independent variable, such as asset size, while holding other factors constant. Similarly, it measures the likelihood that one group of banks (e.g., those examined by the OTS) will receive a higher CRA score than the reference or comparison group (OCC banks). Because there could be complicated causal relationships between examinations where banks have been evaluated more than once under the new CRA procedures, we include in our database only the 1,512 banks that were subject to the initial CRA examination conducted under the new regulations. [57]

Our baseline model includes indicator variables for agency and region (with the OCC and the East Coast serving as the respective reference categories—those to which other banks are compared). We also include the assets of the bank (in billions of dollars) and assets-squared to capture any nonlinear effects. Because large banks may be better able to mount aggressive CRA-related lending and investment programs, we expect bank assets to be positively related to exam scores, but with a diminishing return to additional size. This implies a positive coefficient for assets and a negative coefficient for assets-squared. Finally, we expect that the timing of the exam may also be positively related to test scores, with banks examined later earning higher scores because they can learn from the experiences of banks that were evaluated before them. Because we expect the marginal effect of the learning curve to diminish over time, we included months-squared as a separate independent variable and, as with assets, expect this coefficient also to have a negative sign.

[56] We used ordered logistic regression because the dependent variable is made up of a limited number of ordinal categories. This approach assumes that the independent variables have a constant effect across all ratings categories. For instance, having more assets is presumed to increase a bank's likelihood of receiving an "outstanding" vs. a "high satisfactory" rating just as much as it increases the likelihood of receiving a "low satisfactory" vs. a "needs to improve" rating. Likelihood here refers not to predicted probabilities, but to the ratio of the odds of a higher CRA score for one group (e.g., FDIC banks) to the odds of another (OTS banks). Odds are defined as the ratio of the probability of an event happening to the probability of the event not happening. "Odds ratios" are the ratios of the odds for one group (e.g., FDIC banks) to another (OCC banks).

[57] Analysis that included all 1,954 exams and adjusted for non-independence between multiple exams for the same bank found no substantive differences from the analysis using just the initial exams.

The results of the ordered logistic regression of the overall CRA score (see table 10) largely confirm our earlier bivariate finding (see table 3): OCC scores are significantly lower than those awarded by two of the other three agencies. While there is no statistically significant difference between OCC and FDIC with respect to the distribution of overall CRA scores, controlling for other factors, banks examined by the OTS and FED are 60 and 69 percent more likely, respectively, to receive higher CRA scores.

There is no statistical evidence, however, that region plays an independent role in CRA exam scores when other factors are held constant. This may be because the region variable reflects the location of the bank's headquarters and not necessarily their footprints of operation. Similarly, while we expected to find a learning curve—where banks that were examined later fared better than those examined nearer the effective date the new CRA regulations, we found no such relationship.[58]

However, the size of the bank is highly and significantly related to CRA performance. A billion-dollar increase from the mean overall asset level ($2.3 billion) is associated with a 5 percent increase in the likelihood that a bank will receive a higher overall CRA score. However, as we hypothesized, the asset effect is nonlinear, with the positive effect of size diminishing at higher asset levels. In addition to the baseline effect of bank size, OTS examiners tend to reward size with an additional bump up in score. For every billion-dollar increase (from the overall mean asset level), the average institution evaluated by OTS is 14 percent more likely to receive a higher overall score, compared to an increase of just 5 percent for banks examined by other agencies.

[58] We tested the timing of the exam in various ways, including discrete periods of time such as pre- and post-1997 (when the exam became mandatory), but found no significant results.

Table 10: Ordered Logistic Regression of Overall CRA Score, First Exam Only, 1996-2001

Variable	Coefficient	Odds Ratio	S. E.
Regulator (OCC is reference)			
FDIC	0.25	1.29	(0.20)
FED	0.52 *	1.69	(0.23)
OTS	0.47 *	1.60	(0.23)
Region (East is reference)			
South	-0.20	0.82	(0.21)
Midwest	-0.07	0.93	(0.17)
West	0.002	1.00	(0.25)
Pacific	0.08	1.08	(0.24)
Assets ($ billions)	0.051 ***	1.05	(0.01)
Assets squared ($ quintillions)	-0.0002 **	0.9998	(0.00)
Time (in months) from CRA release to exam date	-0.01	0.99	(0.04)
Months squared	0.0002	1.00	(0.00)
FDIC*assets ($ billions)	0.05	1.05	(0.04)
FED*assets ($ billions)	0.01	1.01	(0.01)
OTS*assets ($ billions)	0.09 *	1.09	(0.04)
Intercepts			
Intercept 1	-7.14		(1.26)
Intercept 2	-3.90		(0.80)
Intercept 3	1.92		(0.78)
-2 Log L: -812.2 Chi Square: 65.4***			

* p < .05; ** p < .01; *** p <.001

N = 1,512

Source: Center for Community Capitalism, CRA Database, 2001

Repeating the analysis for the lending test, we find that because a bank's overall CRA score is so heavily influenced by its lending record—the lending test counts for 50 percent of a bank's overall score—the results mirror those for the overall equation (see table 11). Banks evaluated by the OCC tend to score lower on the lending test than those examined by the other regulators, with the exception of OTS. Neither region nor timing of the exam is statistically significant, but we again see a significant positive relationship between lending test score and assets, which tapers off at the higher extremes. And, once again, larger banks examined by the OTS receive even higher scores than those explained by their size.

Table 11: Ordered Logistic Regression of Lending Score, First Exam Only, 1996-2001

Variable	Coefficient	Odds Ratio	S. E.
Regulator (OCC is reference)			
FDIC	0.45 ***	1.57	(0.14)
FED	0.63 ***	1.88	(0.17)
OTS	0.05	1.05	(0.17)
Region (East is reference)			
South	0.23	1.26	(0.16)
Midwest	0.20	1.22	(0.13)
West	0.07	1.07	(0.19)
Pacific	0.21	1.23	(0.19)
Assets ($ billions)	0.04 ***	1.04	(0.01)
Assets squared ($ quintillions)	-0.0001 ***	0.9999	(0.00)
Time (in months) from CRA release to exam date	-0.05	0.95	(0.03)
Months squared	0.001	1.00	(0.00)
FDIC*assets ($ billions)	0.01	1.01	(0.03)
FED*assets ($ billions)	0.01	1.01	(0.01)
OTS*assets ($ billions)	0.09 *	1.09	(0.04)
Intercepts			
Intercept 1	-7.87		(1.18)
Intercept 2	-5.16		(0.69)
Intercept 3	-1.58		(0.64)
Intercept 4	1.09		(0.64)
-2 Log L: -1,509.8 Chi Square: 66.5***			

* p < .05; ** p < .01; *** p <.001
N = 1,512
Source: Center for Community Capitalism, CRA Database, 2001

Our analysis of investment test scores (see table 12) shows important differences. Banks evaluated by the FDIC are a little more than half as likely to receive higher investment scores than those evaluated by the other agencies.[59] Region also affects the success of banks' community development investment records: banks headquartered in the South are less than 70 percent as likely as East Coast-based banks to receive higher scores, while Pacific Coast-based banks are 44 percent more likely than banks in the East to receive higher scores. However, as with the previous models, we observed no differences in investment test scores based solely on when the CRA exam took place.

Controlling for other factors, asset size also influences investment test scores. A billion-dollar increase in assets increases the likelihood of a bank receiving a higher

[59] The comparison presented in the table is between the FDIC and the OCC (as the reference category). However, by rotating the reference category, we found that the FDIC-evaluated banks scored lower than the OTS and FED banks as well.

investment test score by 6 percent, and the asset effect decreases with size. Large banks evaluated by the FED and the FDIC are about 8 percent more likely to receive a higher investment test score.

Table 12: Ordered Logistic Regression of Investment Score, First Exam Only, 1996-2001

Variable	Coefficient	Odds Ratio	S. E.
Regulator (OCC is reference)			
FDIC	-0.58 ***	0.56	(0.14)
FED	0.01	1.01	(0.17)
OTS	0.15	1.16	(0.16)
Region (East is reference)			
South	-0.37 *	0.69	(0.16)
Midwest	-0.04	0.96	(0.12)
West	-0.13	0.88	(0.19)
Pacific	0.37 *	1.44	(0.19)
Assets ($ billions)	0.06 ***	1.06	(0.01)
Assets squared ($ quintillions)	-0.0002 **	0.9998	(0.00)
Time (in months) from CRA release to exam date	0.03	1.03	(0.03)
Months squared	-0.0002	1.00	(0.00)
FDIC*assets ($ billions)	0.07 *	1.08	(0.04)
FED*assets ($ billions)	0.07 *	1.07	(0.03)
OTS*assets ($ billions)	0.001	1.00	(0.03)
Intercepts			
Intercept 1	-3.48		(0.60)
Intercept 2	-0.82		(0.57)
Intercept 3	1.69		(0.57)
Intercept 4	3.09		(0.58)
-2 Log L: -1,811.7 Chi Square: 137.1***			

* p < .05; ** p < .01; *** p <.001
N = 1,512
Source: Center for Community Capitalism, CRA Database, 2001

Modeling Service Test Scores

Our analysis for the critical service test, summarized in table 13, presents three models of the determinants of service test scores. Model 1 simply replicates our baseline model presented in tables 10 through 12. Among other things, model 1 confirms that the OCC is the toughest grader by far when it comes to evaluating banks' service records. Controlling for other factors, banks examined by the FDIC and OTS were 1.8 times more likely than OCC-evaluated banks to receive a higher service test score. Banks examined by the FED were more than twice as likely to receive higher scores.[60] These results are consistent with a trend

[60] By "twice as likely," we mean that the odds of a higher score for an FED exam are twice that of OCC exams, *not that the predicted probabilities are twice as large*. Odds are defined as the ratio of an event happening to the

noted in our in-depth review of individual CRA examination reports, which we discuss in Part V. There, we find that the OCC seems to be the only agency that regularly requires institutions to provide hard evidence (in the form of product/activity data, etc.) that low- and moderate-income populations use alternative delivery systems (such as telephone or Internet banking) in order to receive points on the service test. Because of this practice, which we applaud, we would expect OCC-service test grades to be lower than those awarded by other regulators.

Service test scores are also positively related to the size of the institution. For every additional billion dollars of assets, the likelihood of receiving a higher service test score increases by 2 percent. Unlike the other exams, there is no evidence that this relationship is nonlinear—that is, the marginal increment in service test score does not diminish with further increases in the bank's assets. To control for the possibility that different agencies would treat bigger banks differently, we included interaction terms for each of them. We found that an additional $1 billion in assets increases the likelihood of receiving a higher service test score by 13 percent for OTS-examined institutions, compared to just 2 percent for other agencies.

Unlike the other CRA component test scores, service test scores are influenced by the bank's regional location. Controlling for both asset size and regulator, banks located in the South and Midwest were significantly less likely than East Coast-based banks to receive a higher service test score. This may be due to higher levels of urbanization and the greater densities of LMI communities in the East, which offer more cost-effective opportunities to locate branch facilities that earn more service test points.

Models 2 and 3 include all the variables shown in Model 1, with the addition of independent variables that capture banks' performances on the lending and investment tests. We added these test scores to our model in order to test two related hypotheses. The first is that banks that earn high scores on the lending and investment tests are also likely to score well on the service test. This is because many banks take their CRA responsibilities seriously and do not want to jeopardize their ability to acquire other institutions, close unprofitable branches, etc., by doing poorly on their CRA exam.

The second hypothesis is that some banks with poor lending and investment records may receive a high service test score. If this is the case, there are two possible explanations. The first is simply that banks with low lending and investment scores work harder on the service exam in the hope this might bump them up to an overall "satisfactory" rating. An alternative explanation of why borderline banks may receive higher than expected service test scores than would be expected on a statistical basis is that examiners do not want to give banks a failing overall grade. Therefore, whether consciously or unconsciously, they inflate

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event not happening. "Odds ratios" are the ratios of the odds for one group (e.g., FDIC banks) to another (OCC banks).

service test scores. As we show below, there is some evidence that grade creep might be the more powerful of these two plausible explanations.

Table 13: Ordered Logistic Regression of CRA Service Score, 1996-2001

	Model 1			Model 2			Model 3		
Variable	**Coefficient**	**S. E.**	**Odds**	**Coefficient**	**S. E.**	**Odds**	**Coefficient**	**S. E.**	**Odds**
Regulator (OCC is reference)									
FDIC	0.57 ***	(0.14)	1.77	0.63 ***	(0.14)	1.87	0.61 ***	(0.14)	1.84
FRB	0.86 ***	(0.16)	2.36	0.72 ***	(0.17)	2.05	0.69 ***	(0.17)	2.00
OTS	0.58 ***	(0.17)	1.78	0.61 ***	(0.17)	1.84	0.53 **	(0.18)	1.70
Region (East is reference)									
South	-0.59 ***	(0.16)	0.55	-0.67 ***	(0.16)	0.51	-0.60 ***	(0.16)	0.55
Midwest	-0.33 **	(0.12)	0.72	-0.43 ***	(0.13)	0.65	-0.34 **	(0.13)	0.71
West	-0.10	(0.18)	0.91	-0.07	(0.19)	0.93	-0.02	(0.19)	0.98
Pacific	-0.18	(0.19)	0.84	-0.34 *	(0.19)	0.71	-0.28	(0.20)	0.76
Assets ($ billions)	0.02 *	(0.01)	1.02	-0.007	(0.01)	0.99	-0.005	(0.01)	1.00
Assets squared ($ quintillions)	-0.0001	(0.00)	1.00	0.00003	(0.00)	1.00	0.00002	(0.00)	1.00
Time (in months) from CRA release to exam date	-0.04	(0.03)	0.96	-0.04	(0.03)	0.96	-0.02	(0.03)	0.98
Months squared	0.0005	(0.00)	1.00	0.0004	(0.00)	1.00	0.0002	(0.00)	1.00
FDIC*assets ($ billions)	0.04	(0.03)	1.04	0.03	(0.03)	1.03	0.03	(0.03)	1.03
FRB*assets ($ billions)	-0.005	(0.01)	1.00	-0.01	(0.01)	0.99	-0.01	(0.01)	0.99
OTS*assets ($ billions)	0.10 **	(0.04)	1.11	0.08 *	(0.04)	1.08	0.08	(0.04)	1.08
Lending score	--	--	--	--	--	--	--	--	--
Investment score	--	--	--	--	--	--	--	--	--
Combined lending and investment	--	--	--	0.35 ***	(0.02)	1.42	--	--	--
Combined Score (7 is reference)									
Combined score <=6	--	--	--	--	--	--	-4.86 ***	(0.78)	0.01
Combined score = 7	--	--	--	--	--	--	--	--	--
Combined score = 9	--	--	--	--	--	--	-1.50 ***	(0.26)	0.22
Combined score = 10	--	--	--	--	--	--	-1.16 ***	(0.26)	0.31
Combined score = 12	--	--	--	--	--	--	-0.41	(0.25)	0.67
Combined score = 13	--	--	--	--	--	--	0.07	(0.28)	1.07
Combined score = 15	--	--	--	--	--	--	1.95 ***	(0.28)	7.03
Combined score >= 16	--	--	--	--	--	--	1.62 ***	(0.29)	5.05
Intercepts									
Intercept 1	-5.97	(0.70)	--	-2.31	(0.74)	--	-6.73	(0.79)	--
Intercept 2	-1.28	(0.59)	--	2.58	(0.65)	--	-1.43	(0.64)	--
Intercept 3	1.22	(0.59)	--	5.51	(0.66)	--	1.76	(0.64)	--
-2 Log L:	-1498.7			-1353.8			-1282.0		
Chi square:	87.8***			377.5***			521.2***		

* p < .05; ** p < .01; *** p <.001 N = 1,512

Source: Center for Community Capitalism, CRA Database, 2001

Model 2 adds to the baseline model the combined point total of the bank's lending and investment test scores, which range from a theoretically possible minimum score of 0 to a maximum potential score of 18 points.[61] The coefficient for the combined lending and investment score is positive and highly significant: for every additional point in the combined lending and investment test score, the likelihood of receiving a higher service test score increases by 42 percent. This finding supports our first hypothesis—banks that do well on one test tend to do well on the others.[62]

While Model 2 confirms an overall positive statistical relationship among the three exam scores, it does not allow us to detect "tipping points,"—points where a minor boost in the service exam could result in a large categorical improvement in the overall CRA evaluation (particularly the threshold between "needs to improve" and "satisfactory", which roughly equates to the difference between passing and failing). These tipping points may provide the impetus for examiners to give (or, possibly, for banks to earn) higher service scores than we would otherwise expect, given the relationships detected in Model 2.

Accordingly, like Model 2, Model 3 includes the combined lending and investment scores, but this time we enter the scores as a series of discrete point totals rather than as a set of continuous values. Banks with a combined score of seven points on the lending and investment tests were used as the reference category, because these institutions rest on an important fault line for the overall CRA exam. The only way they can earn a satisfactory overall rating is by scoring a "high satisfactory" or "outstanding" rating on the service test. The only way banks earned seven cumulative points on the combined lending and investment tests is to receive a "low satisfactory" lending score (worth 6 points) and a "needs to improve" investment rating (worth 1 point).[63] Banks on the edge of a failing overall CRA score may prove to be exceptions to the general finding that banks that do well on one test tend to do well on the others.

Consistent with the other models, our Model 3 analysis indicates that banks regulated by the Federal Reserve were at least twice as likely to receive higher service test scores than those examined by OCC, while FDIC- and OTS-examined institutions were about 1.8 and 1.7 times more likely, respectively, to receive higher ratings. This pattern is repeated, as it was in Models 1 and 2, across regions as well.[64] As in Model 2, controlling for combined lending

[61] Although CRA scores on *individual* exams are ordinal categories and not continuous (or ratio) variables, they are used as continuous variables when the *overall* CRA score is assessed, as individual exam scores are tallied and ratings assigned. Hence, we use the combined lending and investment score as a continuous measure.
[62] In another model not shown, we separated the lending and investment scores, finding strong positive coefficients for both. We have also conducted parallel analyses of the lending and investment exams, with the same findings.
[63] Given such a marginal performance, the only way a bank could earn a "satisfactory" overall CRA rating is by receiving no less than a "high satisfactory" service test score (worth four points). A "low satisfactory" service test score (worth three points) or worse would result in an overall CRA rating of no better than "needs to improve."
[64] One exception is the Pacific region coefficient, which became insignificant in Model 3.

and investment scores, asset size does not appear to have a significant impact on service test performance.[65]

Like Model 2, Model 3 provides support for the first hypothesis, that in general banks that perform well on one exam tend to perform well on the others. Banks with a combined score of six or less on the lending and investment tests are just 1 percent as likely as banks with a combined score of 7 to receive a higher service rating, and banks with combined scores of 16 or more are more than five times as likely as banks with combined scores of 7 to receive a higher service test score.

The Evidence of Grade Inflation

More importantly, however, Model 3 also strongly supports our second hypothesis, that under-performing banks—those on the border between a "needs to improve" and a "satisfactory" rating overall—are *also* more likely to receive higher service test scores than other institutions, including some with significantly better lending and investment records (and the higher scores that go with them). In fact, w*hen banks performed so poorly on the lending and investment tests that they were in danger of receiving a "needs to improve" rating overall (i.e. a combined lending and investment score of 7), their service test scores were much higher than would otherwise be expected. The higher than expected service test scores often gave banks just enough cumulative points—11—to eke out a "satisfactory" rating overall.* Banks on this 7-point fault line scored significantly higher than banks with combined scores of 9 and 10, and were not significantly different from banks with combined scores as high as 13. Separate models for each agency (not shown) confirmed that this trend is consistent across all four regulators.[66]

This peculiar situation is depicted graphically in Chart 1 for a typical bank.[67] The predicted probability of receiving a "high satisfactory" service test rating (worth four points) jumps from below 5 percent (.05) for banks that earn a combined six points or less on their lending and investment tests, to approximately 80 percent (.8) for banks that earn seven points (specifically, a "low satisfactory" on the lending test and a "needs to improve" on the investment test), and then drops back down again as the combined scores on lending and

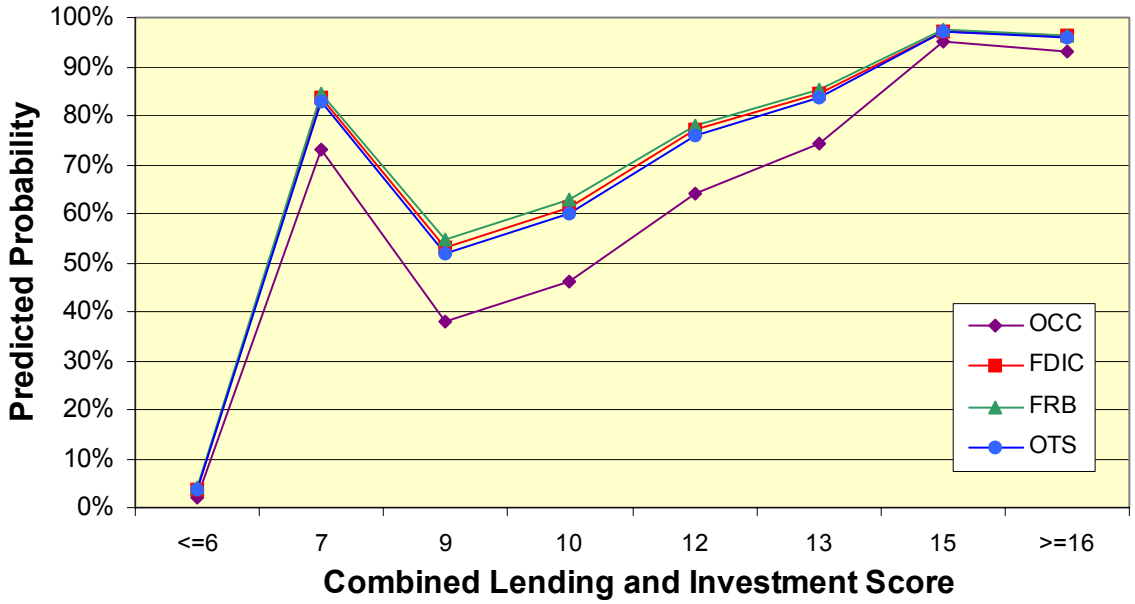
[65]However, in parallel analyses of lending and investment exams (not shown), also controlling for combined scores of the other exams, we continued to find a strong positive relationship between assets and exam performance. This suggests that while assets are an important factor for lending and investment scores, *banks of all sizes can perform equally well on the service test*.

[66] In addition, we ran a multinomial logistic regression (not shown), which models each specific categorical outcome, compared to a base outcome, and provides coefficients for each specific service score. These results strengthen our conclusions from the ordered logistic regression: banks with a combined lending and service score of 7 were fourteen times as likely as banks with combined scores of 9 and three times as likely as banks with combined scores of 15 to receive a "high satisfactory" service score versus a "low satisfactory" score. Furthermore, they were as likely as banks with combined scores of sixteen or more to receive a "high satisfactory" rating.

[67] Although the trend is consistent across all agencies, asset amounts, regions, and number of months since the CRA regulations were released, Chart 1 shows the specific predicted probabilities of receiving a "high satisfactory" service test score for a "base case" bank located on the East Coast, with mean assets and mean months since the regulations release. Thus, a similar spike can be seen for other types of institutions, but the precise predicted probability statistics reflected in the graph only are accurate for base case banks.

investment increase beyond the point where a "high satisfactory" score is required to pass. In fact, the only institutions with a significantly higher predicted probability of receiving "high satisfactory" service test ratings were those that had earned at least 15 points from lending and investment combined (i.e., "high satisfactory" or above on both of the other tests).[68]

Chart 1: Predicted Probability of Receiving at Least a High Satisfactory Score on the CRA Service Test, by Combined Lending and Investment Test Scores and Agency, 1996-2001



Base Case: East Coast bank, mean months (41.4), median assets ($473 million).
Source: Center for Community Capitalism, CRA Database, 2001.

The Chart also shows a second service score inflection when the combined lending and investment score equals 15. At this point, the predicted probability of receiving a "high satisfactory" service score is greater than when the combined score is 16 points or more. This is likely a reflection of a second tipping point, between "satisfactory" and "outstanding" overall CRA ratings. A bank with a combined lending and investment score of 15 requires an "outstanding" service test score (6 points) to receive an "outstanding" overall CRA rating (20 points or more). Although the difference between the two is not significant in this model, in a multinomial logistic regression (not shown), where each outcome is modeled individually, we found that banks with a combined score of 15 were significantly more likely than those with a combined score of at least 16 to receive an "outstanding" service rating.

To summarize, two possible explanations exist for the spike in service test scores for otherwise under-performing banks (i.e., those earning 7 points combined on their lending and

[68] Chart 1 clearly shows that the OCC gives significantly lower scores; a viewer may be surprised at the close pattern the other agencies follow, however. This is a reflection of the similar coefficients for these agencies.

investment tests.) The first is that banks realize their mediocre lending and investment programs are likely to result in low scores, so they plan and execute impressive financial services initiatives that will enable them to achieve an overall satisfactory CRA rating. An example of a bank that may have pursued such a strategy is First National Bank of Central California.[69] To shore up its poor performance in lending and investment, this bank located two-thirds of its six branches, including one newly opened during the CRA examination period, in LMI areas, while conducting 1,600 hours of community development service activities.[70] These activities earned First National a high satisfactory service test rating, and a satisfactory CRA rating overall.

An example of the alternative hypothesis, that examiners inflate service test ratings to help borderline banks move up to a "satisfactory" overall CRA rating, is Midwest Savings Bank of Ohio. Neither of Midwest's two branches is in an LMI area; the bank provided no alternative delivery channels to improve services; and its CRA examination failed to identify any community development service activities.[71] Yet, like First National Bank, Midwest received a "high satisfactory" rating on the service test that brought its overall CRA score up to satisfactory.

Taken as a whole, these results raise a number of questions about the impacts and application of the CRA service test. Evidence that service test ratings are being driven—at least for many borderline banks—by general pressure to give "satisfactory" ratings overall rather than by actual service performance undermines the performance basis of the CRA regulatory framework and supports critics' concerns about grade inflation. On a more specific level, the scoring patterns also create doubts about the strength of CRA incentives for banks to improve their service test performance when "low satisfactory" ratings and even "high satisfactory" ratings are so easy to obtain.

While the investment test genuinely challenges many financial institutions, the fact that all but a handful of banks are receiving passing service test ratings seems to suggest that the test fails to set meaningful minimum performance standards. Thus, although banks that are committed to high CRA performance may work hard to improve the accessibility of their delivery systems and their provision of retail banking and community development services, the general CRA scoring patterns seem to provide little reason for less committed banks to go beyond the status quo in reaching out to unbanked and other underserved households.

V. Qualitative Review of Service Test Reports Supports Statistical Analysis

[69]Because performance data on the six individual service test criteria must be compiled by hand and are discussed and reported inconsistently in CRA Public Evaluation reports, a statistical analysis comparing the borderline banks to the larger population would be extremely difficult. Our in-depth review of a random sample of the seven-point banks' CRA evaluations found evidence that both explanations may be at work. In between the two examples included in the text, we found many banks that received 7 points combined on the lending and investment tests that appeared to have neither particularly strong nor weak service test performance, yet received a "high satisfactory" service test score and thus a cumulative "satisfactory" overall.

[70] First National Bank of Central California, Salinas, Cal. (OCC Nov. 2, 1998).

[71] Midwest Savings Bank, DeGraff, OH (OTS June 17, 1996).

To obtain a clearer picture of how individual criteria are being applied within the service test, we conducted in-depth reviews of more than 100 CRA Public Evaluation reports, with samples drawn from the largest banks and thrifts in the country and from institutions with about $1 billion in assets, to get a sense of how regulators apply the standards to banks of different sizes.[72] A separate article contains a full discussion of common and best practices in the treatment of individual service test criteria.[73] As summarized below, however, the results of our analysis suggest that inconsistencies and inflated ratings are not limited to banks whose overall ratings are on the borderline between "needs to improve" and "satisfactory." While our samples included a number of very thoughtful, detailed assessments of banking services, the overall level of inconsistency across examinations was disturbing and further suggests that the service test provides only weak incentives for banks to improve services to unbanked and other underserved populations.

The problems appear to begin with the regulatory standards themselves, which do not always provide clear directions to examiners. On the element of branch distribution, for instance, federal regulatory materials do not tell examiners what benchmark to use in evaluating whether a particular bank's percentage of LMI branches is good or bad. As a result, some examiners look at the percentage of LMI census tracts in a bank's assessment areas while others consider the percentage of total population or households living in LMI census tracts. This simple difference in benchmarks can produce dramatically different results. Regions Bank of Birmingham, Alabama, for instance, received "high accessibility" ratings because FDIC examiners compared its 19 percent LMI branch distribution to the 23 percent of households living in LMI census tracts, rather than to the 31 percent of census tracts classified as LMI.[74] Yet many examinations assess institutions only under a census tract standard and thus may assign much lower accessibility ratings for the same level of performance. Moreover, because exams generally give branch distribution the most detailed treatment of any of the service test criterion, such discrepancies can have a significant impact on banks' service test ratings.

Regulatory materials concerning deposit accounts also appeared vague and contradictory, which may have contributed to wildly inconsistent treatment of these and other low-cost banking programs in our sample. The crux of the problem appears to be that examinations should consider accounts under two separate prongs of the service test: retail services and community development services. The first focuses on the range of retail services offered in particular census tracts and the degree to which these services are tailored to meet local needs,[75] while the second gives credit for low-cost checking accounts, check

[72] Again, because performance data must be compiled by hand and because many examination reports do not provide full and consistent statistics on all six service test criteria, a statistical analysis was not feasible. Federal regulators do release databases of lending activity for analysis, but similar data on branch distribution, deposit accounts, and other services were not available.

[73] Michael A. Stegman and Kelly Thompson Cochran, "Best Practices Under the Community Reinvestment Act Service Test," Center for Community Capitalism, University of North Carolina, August 2001.

[74] Regions Bank, Birmingham, AL (FDIC Nov. 1, 1999), p. 17.

[75] 12 C.F.R. § 228.24(d)(4); Federal Financial Institutions Examination Council (FFIEC), Community Reinvestment Act Examination Procedures for Large Retail Institutions 11 (April 1997).

cashing programs, savings clubs, individual development accounts, and similar services.[76] However, the actual CRA regulations and official federal examination procedures do not make this dual treatment clear.[77] Perhaps because of this discrepancy, many examinations failed to mention deposit accounts at all or merely stated that bank products were consistent across all branches, without discussing whether institutions had provided low-cost products and services to meet the needs of LMI customers.

A second problem was examiners' failure to follow the standards that are clearly laid out in agency materials. For instance, the CRA regulations state that nonbranch delivery systems should be evaluated as to their availability and effectiveness in serving LMI areas and customers, while other regulatory guidelines emphasize that such channels should receive service test credit only to the extent that they serve LMI customers and neighborhoods. However, many examinations appeared to give credit for the mere existence of telephone banking, Internet banking, and other alternative delivery channels without considering accessibility issues or usage rates. Even in the case of ATMs, which examining agencies could easily subject to the same type of geographic distribution analysis as branches, approximately 20 percent of the examinations we reviewed failed to provide complete data on the percentage of bank ATMs located in LMI census tracts. The one major exception to this problem was the OCC, where examiners stated repeatedly that they did not give significant service test credit for delivery channels if banks could not provide data on LMI service. For decentralized delivery channels, for instance, the OCC exams generally required statistics on the percentage of loans or accounts opened by phone by LMI customers, the percentage of bank-at-work participants who live in LMI areas, or other usage information.

The third and related problem concerns a general lack of quantitative data. Although examiners consistently provided branch distribution percentages in charts in the examination reports, they rarely provided similar statistics on usage of alternative delivery channels, provision of low-cost accounts, participation in financial education seminars, and other community development services. The lack of information about the size of bank programs appeared to hamper examiners' determination of the accessibility of delivery channels and the extent of community development services, as required by the CRA regulations. Moreover, the level of qualitative analysis of these elements was often quite superficial. For instance, many evaluations simply provided a "laundry list" of banks' community development service

[76] FFIEC, CRA Interagency Questions and Answers, 65 Fed. Reg. 25,088, 25096 (Apr. 28, 2000); Notice of Proposed Rulemaking, 59 Fed. Reg. 51,232 n.3 (Oct. 7, 1994); Office of the Comptroller of the Currency Interpretive Letter 728 (June 18, 1996).

[77] The regulations do not explicitly state that retail banking products are eligible for credit as community development services but rather simply define community development services as activities related to the provision of financial services that have a primary purpose of affordable housing, community services to LMI individuals, economic development through small business assistance, and neighborhood stabilization or revitalization. 12 C.F.R. § 228.12(h), (j). Under the retail banking services analysis, in contrast, the CRA regulations explicitly direct examiners to consider "the degree to which [bank] services are tailored to meet the needs" of LMI populations. *Id.* § 228.24(d)(4). Federal examination procedures follow a similar pattern in directing examiners to consider deposit products under the retail banking services analysis with regard to the degree of tailoring and whether products are available at all branches but do not mention deposit products under community development services. Federal Financial Institutions Examination Council (FFIEC), Community Reinvestment Act Examination Procedures for Large Retail Institutions 11 (April 1997).

activities, without discussing the innovation, responsiveness, or general impact of the programs.

In general, the sheer diversity of service test elements and activities seemed to hamper examiners' analysis. While the evaluation reports for banks operating in a relatively small number of assessment areas were often quite thoughtful and detailed in their discussions of service test performance, examinations of large multi-state banks often relied heavily on statistical analysis and formulaic language. The examinations of branch distribution were generally consistent and thorough—with the exception of the benchmarking problem noted above—but the level of analysis for other service test elements appeared to vary widely based on examiner interest and resources, whether the bank happened to have detailed statistics available, the number of assessment areas, and other factors. Many examiners restricted both service test and investment test discussions to just a few paragraphs for each assessment area, while focusing their primary attention on lending activities. However, given that the investment test is much more streamlined than the service test, such space constraints made service test discussions particularly superficial.[78]

Analysis of initiatives targeted to the unbanked was no exception to these general trends. As discussed above, treatment of low-cost checking and savings accounts was perhaps the single most inconsistent part of service test examinations. Only a handful of exams included quantitative information, such as the number of low-cost accounts opened during the examination period or the percentage of accountholders living in LMI areas, and a few reports failed to provide even basic descriptions of bank programs. In one case, an examiner credited a bank for providing a "low-cost" checking account that waived fees only if customers maintained a $1,500 balance, apparently without ever questioning whether such an account was truly responsive to the needs of LMI customers.[79] Non-account programs that provided low-cost check cashing, wire transfers, and other services received even less attention. While a handful of examinations highlighted programs targeting the unbanked, most examinations simply noted check cashing and other services without statistics, descriptions, or discussion of attempts to encourage participants to open accounts. This treatment seemed to imply that examiners did not consider such programs worthy of significant CRA credit.

VI. Proposals for Strengthening the Service Test

The results of our CRA analyses underscore the importance of revisiting the large bank service test as federal regulators complete their comprehensive review of CRA regulations in 2002. The goal of the review is to determine whether the current rules have been effective in "(1) emphasizing in examinations an institution's actual performance in, rather than its process for, addressing CRA responsibilities; (2) promoting consistency in

[78] On paper, the investment test format is similar to the analysis for community development services: it focuses on the amount or extent of investments as well as on qualitative factors such as innovation and responsiveness to community needs.

[79] Citibank, F.S.B., Long Island City, NY (OTS July 12, 1999), p. 29.

evaluations; and (3) eliminating unnecessary [compliance] burden."[80] As detailed in Parts IV and V, the current test falls far short of its potential in meeting the first two regulatory goals. Agencies do not enforce the criteria consistently and fairly among all banks, and evidence that examiners sometimes use the service test to inflate borderline banks' overall CRA ratings dilutes the effect of performance-based standards on the lending and investment tests as well as on the CRA service requirements. Moreover, while the current standards are somewhat successful in evaluating banks' branch networks (and, to a lesser extent, various other delivery channels), they do a relatively poor job of assessing the scope of retail banking and community development services that are actually being delivered through those channels. With extremely high passage rates and often inconsistent and superficial analyses, the service test appears to create only minimal incentives for banks to increase their service performance, particularly through the provision of basic banking products, financial literacy programs, and other community development services.

Like previous CRA reform efforts, however, any attempt to bolster the service test must address a number of underlying political and market realities. The first is that the CRA requirements apply only to banks and thrifts that offer federally insured deposit accounts. This is just one part of the financial services market. Thus, while creating tougher standards may change the behavior of banks and thrifts toward LMI communities, tougher standards would also affect the institutions' competitive position against mortgage companies, check cashers, and other non-depository financial services providers that are not subject to CRA regulation. If tougher CRA requirements have the effect of reducing banks' and thrifts' competitiveness, depository institutions will cede more of the market to non-depository institutions, thereby further reducing the effective scope of the CRA.

A second and related point is that requirements that significantly increase paperwork and other compliance burdens for large banks are likely to provoke strong industry opposition. In fact, it was largely bankers' complaints about the compliance burden under earlier standards that motivated the more performance-oriented 1995 rules; bankers argued that the standards were generally inefficient and put them at a disadvantage relative to other financial service providers. Moreover, it is also important to minimize the burdens placed on CRA examiners. Detailed analyses of local conditions and individual bank programs require significant time and training, and are particularly difficult for examiners who are evaluating large multi-state banks operating in dozens of separate assessment areas. If examiner resources remain at current levels, a heavy new service test compliance protocol might require tradeoffs in how examiners evaluate other CRA requirements.

With these issues in mind, we propose that policymakers and regulators carefully consider ten proposals to make the service test more performance-based. Regulators can implement these reforms under existing law, pursuant to the argument that stronger basic services help families enter the pipeline for credit services. In fact, the first eight recommendations may not even require a change in the CRA regulations, but rather could probably be adopted by simply changing federal examination procedures and examiner

[80] Community Reinvestment Act Regulations, Joint Advance Notice of Proposed Rulemaking, 66 Fed. Reg. 37,602, 37,603 (July 19, 2001).

training. While some of these recommendations do increase the burdens on financial institutions and regulators, we believe that such burdens would be partially or wholly offset by new technology and the benefits that both groups would receive from greater consistency and clarity in the service test. The proposals concern delivery channels, basic banking services, community development services, and the weighting system and structure of the large bank CRA examinations.

A. Improving the Application of Current Standards Concerning Branches and Other Delivery Channels

1. **Federal regulators should adopt the percentage of households living in LMI census tracts within a bank's assessment area as the single, consistent benchmark against which branch distribution is measured**.

As discussed in Part V, the choice of benchmark can have a significant impact on whether a bank's branch distribution is deemed accessible. For the sake of fairness, examiners should use a consistent standard. The percentage of LMI census tracts is a somewhat problematic benchmark, however, because some tracts that are classified as LMI include industrial or commercial districts and actually have very small residential populations. In such cases, focusing on the classification of census tracts rather than on the proportion of total population living in traditionally disadvantaged neighborhoods would provide a distorted view of community demographics. However, because families often maintain a single account or set of accounts for their entire household, the percentage of households living in LMI census tracts appears to be a better standard than the percentage of general population living in LMI tracts.[81]

2. **All CRA examiners should evaluate the availability and effectiveness of alternative delivery systems in serving LMI communities and customers, rather than giving banks and thrifts credit for the mere existence of alternative delivery channels.**

Banks should have the freedom to select among different delivery channels based on popularity with customers, competition with other financial service providers, costs, and other factors. Once a choice has been made, however, the CRA regulations require that examiners evaluate these delivery channels with regard to their availability and effectiveness in serving LMI neighborhoods and customers; other guidelines indicate that examinations should only give credit for alternative channels to the extent they actually serve LMI areas and populations. Actual usage rates would provide the most detailed measure of effectiveness and extent of service but would increase compliance costs. Accordingly, we believe that regulators should use geographic analyses where possible, because they impose very little

[81] It is important to emphasize that the standard should be households and not families specifically, however. Single-person households also need financial services, and the Community Reinvestment Act provides no language suggesting that only families' needs should be considered.

burden on either banks or examiners. Thus, examiners should use the same analysis that is currently applied to branch distribution to assess ATMs, loan production offices, and other physical delivery channels, so that the percentage of ATMs or production offices in LMI areas is compared to the percentage of households living in those census tracts.

Creating consistent analyses for the accessibility of telephone, Internet, bank-at-work, and other decentralized delivery systems is more complicated, because determining the effectiveness and extent of service cannot be accurately assessed without actual usage statistics. As discussed in Part IV, however, the Office of the Comptroller of the Currency has already begun requiring banks to provide data on the percentage of loans or accounts opened by phone by LMI customers, the percentage of bank-at-work participants who live in LMI areas, and similar statistics for other delivery systems channels. We believe that all four regulators should adopt the OCC approach and consistently apply it in all service test examinations.[82]

While consistency is an important factor in this recommendation, additional policy considerations also play a role. Because many banks have begun charging fees for branch transactions to encourage customers to use lower-cost channels such as ATMs and online banking, the actual use of alternative delivery systems has become much more important as branches become effectively, if not literally, less accessible. These changing fee structures and the continuing spread of electronic technology have made alternative delivery channels far more significant than when the current regulations were written in 1995. Today, some Internet banks have little or no branch presence, so that their delivery of retail services depends entirely on alternative channels. Thus, as banks face increasing market pressures to move beyond bricks-and-mortar delivery channels, CRA examination procedures must keep pace to assure customer accessibility.

3. Give more weight to ATMs that accept deposits, bank-by-phone systems that allow customers to open accounts or apply for loans, and other delivery channels that offer a broad range of deposit and loan services.

Within particular delivery channels, there is often a broad range of sophistication. For instance, a simple cash dispensing machine provides far fewer financial services than one that accepts deposits, transfers money between accounts, cashes checks, and so on. Similarly, some phone and Internet banking programs only provide basic interest rates, balance information, and transfers between accounts, while others allow customers to apply for loans, open accounts, and make third-party payments. Because the range of services provided determines how effectively alternative channels can substitute for traditional branches, regulators should evaluate the range provided by particular delivery channels and give extra CRA credit for more comprehensive services.

[82] In fact, the OCC's more rigorous alternative delivery systems analysis may help to explain why the agency's service test scores were significantly lower than the other agencies. See Part IV for more discussion.

B. Improving the Application of Current Standards Concerning Accounts and Other Retail Banking Services

4. Subject to possible changes discussed in Recommendations 9 and 10, banking regulators should clarify that retail banking products are to be considered under two elements of the current service test: (1) the range of services offered in particular census tracts; and (2) the extent that low-cost checking accounts, check cashing programs, savings clubs, individual development accounts, and similar services are provided as a form of community development services.

As discussed in Part V, treatment of deposit accounts was so inconsistent in our sample that some examiners appeared to be confused about whether "lifeline" checking and other low-cost retail products are even part of the service test analysis. Thus, if the agencies maintain the current standards on the treatment of accounts and other products under the service test, they should clarify the language in all guidance materials and should improve examiner training to ensure that all examiners consistently inquire about low-cost retail products that financial institutions offer as community development services as well as to ensure that each branch offers a full range of products.

5. Examiners should consistently analyze the size of low-cost account programs and other community development retail services to determine the true extent of the bank's service test offerings and the degree to which such offerings are innovative and responsive to community needs.

While federal regulators refused in 1995 to base the service test on general deposit growth, the CRA regulations state that community development services should be evaluated as to (1) the extent of the bank's service provision and (2) the innovation and responsiveness of the service in meeting community needs. Ensuring consistent application of these standards is particularly critical given widespread complaints by community groups that banks with low-cost products sometimes refuse to promote them or even to inform consumers of their existence when asked directly about availability. While data reporting requirements should not be so burdensome that institutions decide not to offer any basic banking programs at all, examiners need to perform some systematic quantitative analysis to distinguish between token efforts and substantive programs. They also need to provide stronger incentives to banks to reach out to more LMI customers. Simply inquiring as to the number of low-cost accounts maintained or opened by the institution during the current examination cycle or the number of checks cashed for non-accountholders—even without analyzing such services by geography—would be a significant improvement over current examination methods and would allow examiners to award more credit to banks that provide extensive services.

6. Banks and examiners should provide the same type of qualitative and quantitative analysis for programs that provide transaction services for "unbanked" populations as for traditional low-cost account programs.

Although there is some debate among community advocates over whether banks should receive CRA credit for check cashing and similar activities**,** examiners are in fact

directed by federal examination procedures to consider whether particular community development services target new groups of customers.[83] Giving greater attention to low-cost check cashing, money orders, bill payments, and other stand-alone transaction services could encourage banks to compete more directly with fringe bankers. Likewise, inquiring whether banks are taking steps to encourage unbanked populations to transition to full-fledged accounts could prompt banks to become more innovative in serving the immediate needs of unbanked populations.

C. Improving the Application of Current Standards Concerning Financial Literacy Seminars and Other (Non-Retail) Community Development Services

7. Federal regulators should develop specific benchmarks for the most common types of community development services, so that examiners can apply consistent measurements and qualitative standards to financial education programs, technical assistance to community organizations, school banking programs, and other common activities.

As with low-cost banking products, regulators need to make enforcement of current CRA regulations regarding the provision of non-retail community development more consistent. Again, while the service test regulations require the analyses of (1) the extent of each bank's community development service provision and (2) the innovation and responsiveness of each service in meeting community needs, too many evaluations simply provide a laundry list of activities without any analysis. Admittedly, using a rigid mathematical approach similar to branch distribution would be difficult with regard to community development services because there is no clear system for weighing one type of activity (an IDA program, for example) against another (such as technical assistance to a small business). Moreover, because the definition of community development service is quite broad, examiners need flexibility to recognize new and experimental initiatives. However, for the most common types of services, developing a standard set of evaluation criteria would be relatively simple and would eliminate much guesswork for both banks and examiners. Such guidelines would also help ensure that examiners can distinguish between token and substantive efforts.

For instance, we believe examiners could and should evaluate community development services based on the hours of staff assistance to community organizations, the number of financial education seminars offered, the number of attendants at such seminars, and the number of students involved in school banking programs. Such evaluations would be appropriate measures of the extent of those particular community development services. Qualitative analyses could focus on whether a bank has developed a new program, whether the program addresses particularly urgent needs, such as educating consumers about predatory lending or working with unbanked populations, and on a number of other factors. Thus, while analyses of community development services cannot and should not be reduced to a

[83] Federal Financial Institutions Examination Council, Community Reinvestment Act Examination Procedures for Large Retail Institutions 11 (April 1997).

mechanical formula, CRA regulations need a consistent balance between quantitative and qualitative evaluation in order to maintain consistency and strengthen incentives for financial institutions to serve greater numbers of LMI households.

8. Examiners should also give service test credit to banks that sponsor independent evaluations of the effectiveness of their community development service programs.

With regard to financial literacy programs, for instance, examiners sometimes report data on the number of seminars or participants but almost never provide information on how many "graduates" obtained loans, opened accounts, or otherwise improved their financial status. Tracking seminar graduates' behavior or otherwise evaluating the effectiveness of particular activities can be extremely burdensome and may not be feasible for either banks or CRA examiners to perform for every examination cycle. However, it is important from a policy perspective to encourage institutions to use the most effective curricula available and to structure their programs to have real impact in the larger community. Providing credit for evaluation programs would further this goal.

D. Changing the Weighting System and Basic Structure of the CRA Service Test.

Beyond these proposals to improve enforcement of current service test standards, we recommend two more fundamental changes in the service test. Because these issues attracted significant debate during the 1995 rulemaking process, the regulatory agencies would need to address them as part of the formal notice-and-comment review of CRA standards. Although both are likely to be somewhat controversial, they constitute major improvements that would help the service test live up to its potential in encouraging banks to assist unbanked and underserved families achieve financial stability and qualify for credit services over time.

9. Pending resolution of certain technical issues, examinations should assess all large banks based on the number of accounts per census tract, as determined by the mailing address for account statements.

As discussed in Part II, federal regulators rejected a proposal during the 1995 rulemaking process to base the service test on deposit growth, both because they feared it would require burdensome geo-coding of deposit accounts and because they argued that such a requirement would not be consistent with the CRA statute's focus on credit services.[84] However, we believe that it is time to reconsider the weight and treatment of deposit services for a number of reasons.

First, the development of full-service banking relationships plays a vital role in helping LMI households achieve financial stability and access credit services over the long term. Specifically, accounts help bank customers by providing low-cost transaction services, building a historical record of spending and financial management, and facilitating savings for down payments and other expenses. With a modest amount of financial reserves, families can

[84] Final Notice of Rulemaking, 60 Fed. Reg. 22, 155 (May 4,1995).

avoid having to turn to payday lenders and other predatory sources of credit in temporary emergencies. Instead, they can build savings over time and leverage those resources with credit to pay for homes, educational expenses, and other investments that build wealth within LMI communities. Thus, as discussed in Part II, lower-income households with bank accounts are far more likely than their unbanked peers to have credit cards, home mortgages, and assets such as certificates of deposit.

Yet while both the short-term and long-term benefits of account ownership are clear, the CRA must focus attention and incentives on providing initial retail financial services as well as on making downstream loans. An unbanked family's transition from relying on check cashers and other fringe bankers for basic financial services to qualifying for home or business loans may take months or years, and households may move, switch financial institutions, or encounter setbacks along the way. If we expect banks to make initial investments up front without reasonable certainty as to when they will earn CRA lending credit in return, then we must treat deposit accounts and other ground-level services as distinct CRA elements in their own right. Analyzing deposits by location would provide systematic attention and rewards for bank efforts to develop full-service relationships within LMI communities.

Second, adding a deposit analysis would make the service test more performance-based by focusing attention on the level of financial services actually being provided rather than continuing to concentrate predominately on what channels are available to deliver such services. Community activists rightly emphasize that branches play an important symbolic role in LMI communities, both by demonstrating commitment to local customers and by anchoring economic development, and we do not propose dropping branches from the service test. However, as federal regulators recognized when they refused in 1995 to give credit for the mere existence of marketing campaigns, examinations must judge branches and other delivery channels primarily by the results they produce. The lending test already does this as to loans that are initiated in branches, by phone, or through other media. However, until the service test systematically evaluates banks' provision of upstream financial services, delivery channels remain only a rough proxy of actual service delivery. Thus, while ensuring basic accessibility is important, directly measuring bank services is a more straightforward and powerful way to create incentives for institutions to reach out to underserved populations. Shifting the balance between the two elements would also give banks more freedom to respond to competitive pressures and technological developments in choosing the most efficient delivery channels available to ensure service delivery and in finding new means to serve unbanked populations profitably.

Finally, because banks have made extensive technological improvements in response to Year 2000 concerns and as a means of improving their own marketing and customer relationship programs,[85] the compliance burdens of a deposit analysis are far less taxing now than they were seven years ago. Although tracking accounts by customer income level would be difficult (banks do not routinely ask accountholders for the same background information they ask of loan applicants), banks have ready access to locational information in their

[85] See, for example, Michael A. Stegman, *Savings for the Poor*, op. Cit., pp. 54-58.

statement databases.[86] If determining the census tracts of mailing addresses proved difficult, zip codes would provide another potential basis for geographical analysis.

10. Change large bank examinations to make it easier for institutions with limited investment opportunities to shift their focus to providing more basic banking services

Adjusting the balance between service and investment activities is important for several reasons. First, it would address one of the major controversies concerning large bank examinations heading into the 2002 regulatory review. As indicated by the data in Part IV, many banks are finding it hard to do well under the investment test, a fact that has been confirmed by former FDIC Chairwoman Donna Tanoue.[87] Many small and rural institutions have complained that the number of investment opportunities in their assessment areas are quite limited and that they often cannot compete for existing investment opportunities against larger banks. Second, providing more flexibility in the tradeoff between investment and services would allow banks to improve their competitive positions by concentrating on their core operations of providing basic retail products and increasing deposits. Finally, greater weight for the service test would strengthen the incentives for banks to provide accounts, check cashing, financial education, and other services to unbanked and underserved populations.

The Advanced Notice of Proposed Rulemaking for the CRA regulatory review discusses one option that might facilitate this goal: create a separate community development test that would incorporate community development lending, investment, and service activities.[88] We believe this change would have some advantages, particularly if the analysis of delivery channels, deposit distribution (as proposed in Recommendation 9), and the range and degree of tailoring of other basic retail banking services were retained in the service test. While examiners would still face difficult issues within the new community development test as to how to weigh one type of activity against another—in fact, such problems would be exacerbated, because community development loans and investments would be added to the list of eligible activities—the new configuration would provide greater focus on core bank functions within the lending and service tests and greater flexibility for institutions that have a difficult time finding investment opportunities.

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[86] We recognize that some accountholders have their bank statements sent to a business address or post office box, rather than to a home address, but the fact that a certain number of accounts could not be included in the examination database does not negate the value of the analysis. A not inconsequential number of mortgage applications omit the applicant's race, but this does not negate the value of the racial and neighborhood analysis of loan approvals and denials, which the routine reporting of HMDA data by covered institutions makes possible.

[87] Barbara A. Rehm, "Disappointing CRA Fund Gets a Lift," *American Banker*, October 17, 2000, p. 4.

[88] See Community Reinvestment Act Regulations, Joint Advance Notice of Proposed Rulemaking, 66 Fed. Reg. 37,602, 37,605-06 (July 19, 2001). This idea had also been raised in letters of comment on the 1995 regulations and by former FDIC Chairwoman Tanoue in discussing large banks' struggles with investment test criteria. Michele Heller, Tanoue: "Consider Dropping Investment from CRA Exam", *Am. Banker*, June 20, 2000, at 6.

Alternatively, we propose a second option that would shift the weighting between the current service and investment tests: either change the 25 percent-to-25 percent ratio to some other fixed number, or allow banks at their option to increase the weight of the service test up to 35 percent or 40 percent. In return for the greater weight, however, banks would be expected to demonstrate significant outreach and actual service to unbanked and underserved populations. This would enable a bank that is having difficulty locating sufficient equity investment opportunities—which is not a core business—to do more to deliver financial services in LMI communities—which is a core business—and improve its overall CRA score.[89] A related idea proposed during the 1995 rulemaking process is to require banks to earn at least a "low satisfactory" service test score in order to receive a "satisfactory" overall rating, although this would have virtually no effect if current service test passage rates continue (see Part IV). Thus, for either of these proposals to have a real impact, they would have to be adopted in tandem with the earlier recommendations to ensure more rigorous and consistent evaluations of basic financial services.

VII. Conclusion

Given federal budget constraints and current political conditions, strengthening the CRA service test is one of the more promising strategies for helping underserved populations and communities accumulate savings and access credit. A stronger test would encourage banks to increase basic financial services and would complement EFT and other Treasury Department initiatives to create low-cost electronic products for unbanked families. Rewarding banks up front for outreach services could help them map out market opportunities that are both profitable for themselves—especially when combined with cost-cutting technologies and potential economies of scale—and beneficial to LMI communities and households.

At the same time, reconfiguring the service test is important to strengthening the Community Reinvestment Act itself. A more consistent and performance-based service test would make it more difficult for examiners to skew ratings—consciously or unconsciously—to help banks avoid the consequences of poor performance on other CRA requirements. And more detailed and weighty evaluations of the level of retail banking and community development services actually provided would help to strengthen financial institutions' competitive position by emphasizing performance of core banking functions. Rather than continuing to concentrate so heavily on delivery channels in isolation, a strengthened service test would focus on building the kind of long-term relationships that help LMI customers build savings and access credit.

The ten recommendations presented in this article would not create a perfect service test by any means. They also leave out many issues and measures that could be used to create a more nuanced and comprehensive evaluation of banking services and delivery channels. However, in the face of so many broad criteria, simply ensuring the consistent application of basic measures in all parts of the service test would be a major improvement over the current situation. Given the structure of the Community Reinvestment Act, the

[89] See, for example, Michael A. Stegman, *Savings for the Poor,* (1999).

logistical limitations on examiners, and the market pressures facing CRA-regulated financial institutions, we believe that these recommendations are an ambitious and far-reaching set of changes. Implementation would not be easy, and compliance burdens in some areas would increase. However, the long-term benefits promise a stronger CRA regulatory regime, new market opportunities for banks, and—most importantly—greater wealth and access to credit in lower- and moderate-income communities.

APPENDIX A

LARGE BANK CRA EXAMINATIONS DATABASE

The Federal Financial Institutions Examination Council (FFIEC) maintains a database of CRA examination results but does not track performance on the separate lending, investment, and service tests for large banks. Accordingly, the Center for Community Capitalism augmented the FFIEC database by compiling data from 1,954 CRA Public Evaluation reports released between January 1996 and January 2001. The database includes all known large bank examinations that were completed and released to the public during the first five years of implementation under the new CRA regulations, except for approximately 70 reports that could not be obtained in time to be included in the analysis. Most of the missing examinations are from inactive institutions formerly regulated by the Office of Thrift Supervision and Federal Deposit Insurance Corporation.

In compiling the data from individual agency websites, we found more than three hundred errors and omissions in the FFIEC database and another seven errors committed by examiners in calculating CRA ratings (see table 14.) While both types of errors are disturbing, the FFIEC's 16 percent error rate among large bank examinations is particularly noteworthy, because that database is the primary source for researchers and community advocates who analyze trends in CRA scoring patterns over time. Moreover, because we did not track errors for other types of examinations, the overall database may contain additional problems.

Table 14

FFIEC Database Errors by Type and Regulator

	OCC	FRB	OTS	FDIC	TOTAL
Examination Type Miscoded As:					64.0%
"Small bank"	0.0%	0.0%	33.3%	100.0%	(N=201)
"Community develop."*	0.0%	0.0%	66.7%	0.0%	
No type	100.0%	0.0%	0.0%	0.0%	
	(N=143)	(N=0)	(N=3)	(N=55)	
Omitted Exams					34.3%
1997	18.2%	0.0%	0.0%	0.0%	(N=108)
1998	3.0%	0.0%	0.0%	0.0%	
1999	24.2%	0.0%	0.0%	4.2%	
2000	54.5%	100.0%	3.0%	66.7%	
2001	0.0%	0.0%	97.0%	29.2%	
	(N=33)	(N=18)	(N=24)	(N=24)	
Examination Rating Miscoded As:					1.6%
"Outstanding"	0.0%	0.0%	100.0%	0.0%	(N=5)
"Satisfactory"	100.0%	0.0%	0.0%	100.0%	
	(N=1)	(N=0)	(N=1)	(N=3)	
TOTAL AGENCY ERROR RATES	36.8%	5.6%	8.1%	10.2%	16.1%
	(N=481)	(N=321)	(N=345)	(N=807)	(N=1954)

*The community development test is applied to wholesale and limited purpose banks.

Table 14 lists the 314 errors in the FFIEC database by type and regulator. The largest problem by far was miscoding or not reporting examination type, so that examinations conducted under the large bank procedures could not be identified easily within the database. The type of miscoding problem varied by regulator: 143 OCC examinations had no type reported, 55 FDIC examinations were miscoded as small bank exams, and 3 OTS exams were miscoded as community development or small bank exams. The second most common problem was omissions from the FFIEC database. Most of the 108 examinations that were omitted had been released in 2000 or January 2001 and may simply indicate a lag in updating the FFIEC data. However, seventeen large institution examinations from 1997 to 1999 also did not appear in the database. Finally, the overall CRA ratings for five large institutions were miscoded: four institutions had received "satisfactory" ratings but were coded as "outstanding," while one "outstanding" institution was listed as "satisfactory." We corrected those errors in the Center's database.

On the examiner errors, six involved institutions that should have been rated as "satisfactory" based on the total points earned from the individual lending, investment, and service tests (i.e., they earned 19 points or less) but instead were assigned "outstanding" ratings (minimum requirement of 20 points). The FDIC made three of these errors, the Federal Reserve two, and the OTS one. All occurred between 1998 and 2000, so they do not appear to be explained by early unfamiliarity with the large bank standards.[90] The institutions' overall ratings were left unchanged in the Center's database because the ratings were official even though they were calculated incorrectly. The seventh error involved an FDIC examiner who appeared to use four ratings categories (outstanding, satisfactory, needs to improve, and substantial noncompliance) on the lending, investment, and service tests instead of the five categories mandated by federal regulations (outstanding, high satisfactory, low satisfactory, needs to improve, and substantial noncompliance).[91] Based on the textual descriptions of performance, we listed the bank as receiving "low satisfactory" ratings on lending and investment and "high satisfactory" on service.

[90] Federal Reserve Board, CRA Public Evaluation for Peoples Bank and Trust Company, Selma, Ala. (Jan. 12, 1998); Federal Reserve Board, CRA Public Evaluation for Mercantile Bank, Overland Park, Kans. (Sept. 8, 1998); Federal Deposit Insurance Company, CRA Public Evaluation for Citizens First Bank, Rome, Ga. (Apr. 1, 1999); Federal Deposit Insurance Company, CRA Public Evaluation for The Ohio Bank Company, Gallipolis, Ohio (July 1, 1999); Federal Deposit Insurance Company, CRA Public Evaluation for Cohutta Bank Company, Chatsworth, Ga. (Jan. 1, 2000); Office of Thrift Supervision, CRA Public Evaluation for Mascoma Savings Bank, Lebanon, N.H. (June 21, 1999).

[91] Federal Deposit Insurance Company, CRA Public Evaluation for First Republic Bank, Las Vegas, Nev. (July 1, 1998).

APPENDIX B

CHANGE IN EXAMINATION SCORES

Approximately 30 percent of the 1,500 banks in our database were examined twice since the new CRA regulations took effect, and fourteen banks were examined three times. Table 15 shows the distribution of categorical change in the overall CRA score between the first and second examinations for 436 banks. The vast majority (82 percent) of all banks kept their same score. Relatively few (11 percent) jumped one or two categories, and even fewer (8 percent) dropped a category.

Interestingly, 40 percent of all banks that had an "outstanding" initial evaluation dropped a level to "satisfactory" overall. On the other hand, almost all (89 percent) of the few banks that failed to receive a "satisfactory" initial score improved by at least one category on subsequent exam(s). There were fewer differences across regulators, although the OCC and OTS were somewhat less likely to give improved grades than the Fed or FDIC.

Table 15: Change in Overall CRA Score, by Initial Score and Agency, 1996-2001

	Change in Overall CRA Score				
	+2	**+1**	**0**	**-1**	**Total**
Overall:	0.2%	11.2%	80.7%	7.8%	100%
Initial CRA Rating:					
Outstanding (n = 83)	--	--	60.2%	39.8%	100%
Satisfactory (n=335)	--	10.2%	89.6%	0.3%	100%
Needs to Improve (n = 17)	5.9%	82.4%	11.8%	0.0%	100%
Substantial Noncompliance (n = 1)	0.0%	100.0%	0.0%	--	100%
Agency:					
OCC (n = 92)	1.1%	7.6%	84.8%	6.5%	100%
FDIC (n = 179)	0.0%	13.4%	79.3%	7.3%	100%
FRB (n = 85)	0.0%	9.4%	83.5%	7.1%	100%
OTS (n = 77)	0.0%	13.0%	79.2%	7.8%	100%

N = 432

Source: Center for Community Capitalism, CRA Database, 2001

Finally, regression analysis of the scores of the second exams revealed the same basic patterns, including the grade inflation we reported with respect to the service test. Banks with combined lending and investment scores of 7 were more likely (although only at the .10 level) than banks with combined scores of 9 to receive higher service scores.