The Bottom Line – December 2023
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Why are bank regulators destroying the Community Reinvestment Act? The unintended consequences remind me of one of my favorite quotes from *Star Wars*, in which my teenage crush, Princess Leia, schools Grand Moff Tarkin: "The more you tighten your grip…the more star systems will slip through your fingers."

Speaking of 1977, CRA was adopted that same year on the slimmest of margins. The law was repeatedly scaled back in order to win passage. In the end, it was written as a directive to regulators to "encourage" financial institutions "to help meet the credit needs of the *local* communities in which they are chartered." In large part, the law has been very effective in encouraging banks across the country to engage in community good. From most outward measures, the implementation of the law has been a success!

You would think that the focus of regulators attempting to modernize the CRA rule would be to expand on this success. But instead, their new rule creates massive disincentives by introducing risks, costs, and uncertainty that will likely result in a massive pullback in credit in many communities across America. I dare say this rule may ultimately be recognized as the most arrogant failure yet of the current crop of unhinged bureaucrats striving to exercise unbridled legislative power. Congress required these agencies to use their power to encourage banks, and they have done the exact opposite!

Banks overwhelmingly support the Community Reinvestment Act. Every bank I know takes CRA seriously and works hard to serve the local community in which it is chartered. Regulators had the perfect opportunity to modernize the existing rule by refining what qualifies and clarifying how a bank would be evaluated. This predictability would have encouraged even more benefit in more communities.

Instead, they went way beyond the law to incentivize what banks should look like, how they should be structured, and what products and services they should offer to which Americans. They dramatically increased the cost of compliance, and adopted a grading regime where banks won't know if they earned a passing grade until well after they can do anything about it. In other words, they significantly tightened their grip! And as Princess Leia suggested, the only thing that encourages is rebellion.

Banks of all sizes and shapes will be forced to reduce compliance risk by walking away from certain types of loans for fear of triggering unrealistic compliance burdens. In some instances, banks will abandon the very lending products advocates were hoping to expand. Additionally, banks will be forced to manage compliance risk by backing away from any geographic area where they aren't confident they can compete for a good score. Isn't that exactly what Congress was trying to eliminate? I even predict that bank examiners are going to hate this new rule because it puts them in a terrible, no-win situation with those they regulate.

What is most troubling is that bankers made every effort to explain these consequences to those leading the drafting process, only to discover that several of the most fundamentally unresolvable problems we raised were never included in summaries prepared for those voting on the rule.

So I ask myself, “In what way does this new rule improve or enhance regulators’ ability to ‘encourage’ banks ‘to help meet the credit needs of the local communities in which they are chartered’?” It doesn’t! It does the opposite, introducing risks, costs, and uncertainty that will result in less CRA activity, not more. In short, the more they tightened their grip in this new rule, the more they betrayed the underlying statute and the public policy purpose of the Community Reinvestment Act.

In the end, I’m afraid that some banks will be forced to make a cost benefit decision that the credit needs of the local communities in which they are chartered will be better served if they take all the money they would spend trying to comply with the new rule and simply spend that money on the actual needs of their community, effectively ignoring the arbitrary ratings of these dictatorial regulators. “But Howard, won’t the agencies punish those banks?” I’m sure they will try, but in this case, the agencies actually betrayed themselves. Any future punishment based on the new ratings will likely be challenged in court, given the fact that the standards would have been established after-the-fact. That is simply un-American.

This new rule will destroy CRA as we know it. It doesn’t encourage banks to expand financial services, it does the opposite. Regulators will boldly spin this as modernization. I call it an unmitigated disaster.