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Article

The Community Reinvestment Act: A Preliminary Empirical Analysis

by
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Introduction

In recent articles, Professors Jonathan R. Macey of Cornell Law School and Geoffrey P. Miller of the University of Chicago Law School have exchanged views with Professor Peter P. Swire of the University of Virginia Law School regarding the Community Reinvestment Act (CRA). Under the CRA, banks, thrifts, and their holding companies are required "to help meet the credit needs of the local communities in which they are chartered consistent with the safe and sound operation of such institutions." Each year, federal bank-

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4. Certain types of depository institutions such as credit unions are not covered by the statute. See 12 U.S.C. § 2902(2) (1988 & Supp. IV 1992); Macey & Miller, supra note 1, at 292 n.2, 312.

[383]
ing regulators examine and evaluate depository institutions with respect to their compliance with the CRA.6

In their article, Professors Macey and Miller present a strong critique of the CRA. The article essentially argues that the statute's requirement that depository institutions meet local credit needs while maintaining "safe and sound" operations is in many respects oxymoronic. The authors argue the CRA fosters "inefficient credit allocation,"7 frequently forcing banks to make bad loans. The CRA in effect penalizes those banks that have conservative lending policies and those that hold assets in the form of marketable securities.8 They also assert the statute forces a nongeographically diversified allocation of assets,9 and constitutes a considerable regulatory paperwork and public relations burden for depository institutions.10

In response to Professors Macey and Miller, Professor Swire offers the novel proposal of a CRA "safe harbor."11 According to Professor Swire, the standards used by federal banking CRA regulators are extremely vague and subjective, thereby placing a tremendous compliance burden on depository institutions.12 He thus argues a bank should be guaranteed favorable treatment with respect to the CRA if it achieves certain CRA performance levels.13 Under the safe harbor proposed, many of the CRA's present problems arguably would be ameliorated.14 Professors Macey and Miller counter, however, that while Professor Swire's proposal "would mitigate some of the uncertainties that attend the CRA as presently administered," his approach would "not address the fundamental problems with the stat-

6. 12 U.S.C. § 2903 (1988 & Supp. IV 1992). The term "federal banking regulators" includes the Office of the Comptroller of the Currency, the Federal Reserve, and the Federal Deposit Insurance Corporation (FDIC). The Office of the Comptroller of the Currency (a unit of the Treasury Department) has primary supervisory responsibility for federally chartered banks. The Federal Reserve has the primary supervisory responsibility for state-chartered banks that are members of the federal reserve system. The FDIC has primary supervisory responsibility for state-chartered banks that are not members of the Federal Reserve System. See Spong, supra note 5.
7. Macey & Miller, supra note 1, at 293 n.12, 309.
8. Id. at 318, 321-22.
9. Id. at 295, 304-10, 324.
10. Id. at 324-26, 330-33.
11. Swire, supra note 2, at 349.
12. Id. at 355-56, 361.
13. Id. at 349-50.
Indeed, in a July 19, 1993 "op-ed" article, Professor Macey argued that the CRA should be scrapped.\textsuperscript{16}

Professors Macey, Miller, and Swire all strongly agree, however, on the need for empirical analysis with respect to this subject.\textsuperscript{17} We have embarked on a preliminary analysis of this kind. Fortunately, the Financial Institutions Reform, Recovery and Enforcement Act of 1989\textsuperscript{18} mandates public disclosure of all regulatory agency CRA evaluations and ratings issued on or after July 1, 1990. We collected the CRA ratings for all banks\textsuperscript{19} that were rated from July 1, 1990 through the first quarter of 1992.\textsuperscript{20} The range of possible ratings includes (1) "outstanding," (2) "satisfactory," (3) "needs to improve," and (4) "substantial noncompliance."\textsuperscript{21} We then collected a wide range of financial and other data with regard to these institutions, including asset size, membership in a holding company, profitability, makeup of loan portfolio, assets held in marketable securities, and "publicly traded" versus "nonpublicly traded" status.\textsuperscript{22} Finally, we correlated this information with the given CRA ratings.

The results support the general assertions regarding the statute made by Professors Macey, Miller, and Swire. The results show that, as Professors Macey and Miller assert,\textsuperscript{23} banks interested in expansion

\begin{footnotes}
\item[15] Macey & Miller, supra note 1, at 293 n.12.
\item[17] \textit{See} Macey & Miller, supra note 1, at 294; Swire, supra note 2, at 351-52 n.8, 377 n.98.
\item[19] Although the CRA covers other types of depository institutions, our empirical study deals only with banks.
\item[20] A total of 4,365 ratings were collected from the FDIC, the Federal Reserve Board, and the Comptroller of Currency starting with July 1, 1990, up through released agency ratings for February-March 1992. The sources in which agency ratings were found include Federal Reserve Press Release, Dec. 10, 1991 (on file with Graduate School of Business, Texas A&M University) (containing Federal Reserve Board CRA ratings from July 1, 1990 to Nov. 15, 1991).
\item[23] \textit{See} Macey & Miller, supra note 1, at 300.
\end{footnotes}
do indeed have higher CRA ratings. But there are also interesting anomalies in the CRA ratings data. For example, Professors Macey and Miller emphasize the case of Cambridge State Bank of Cambridge, Minnesota, which received a “substantial noncompliance” CRA rating because it had too many assets in bonds and marketable securities and had been too conservative in its asset allocation practices. Our data, however, somewhat surprisingly show that depository institutions with large proportions of assets in marketable-investment securities overall have above-average CRA ratings.

This and other counterintuitive empirical results seem to strongly support Professor Swire’s underlying assertion, which was also forcefully made by Professors Macey and Miller, that the CRA rating standards are so vague that the rating agencies can basically assign any CRA ratings they want. Indeed, regulators may be using the CRA ratings as something of a “stick” with which to take action against institutions they hold in disfavor for other reasons. Thus, there may be something more to Cambridge State Bank’s CRA rating than otherwise meets the eye. Overall, the data strongly support Professor Swire’s call for more specific standards in this area, whether by way of safe harbors or another approach.

What follows is a review of our preliminary empirical results in the context of both the Miller and Macey and Swire articles, as well as President Clinton’s July 15, 1993 call for CRA reform and the Clin-

24. Tables One, Two, Three, and Four, which appear infra in the Appendix, show that banks that are part of holding companies and have large numbers of affiliates—both good proxies for expansion activity—have higher CRA ratings.

25. Macey & Miller, supra note 1, at 318.

26. Tables Three and Four show that with all other factors held constant under logistic regressions, banks with high CRA ratings have significantly more of their assets in government securities than banks with low CRA ratings.

27. For example, Table One shows that banks with low CRA ratings make more consumer and multifamily residential loans.

28. See Swire, supra note 2, at 369-71.

29. See Macey & Miller, supra note 1, at 326-30.


31. See Memorandum from President William J. Clinton to Hon. Eugene A. Ludwig, Comptroller of the Currency; Hon. Andrew C. Hove, Acting Chairperson, FDIC; Hon. Alan Greenspan, Chair, Board of Governors, Federal Reserve System; and Hon. Jonathan Fiechter, Acting Director, Office of Thrift Supervision, The White House, July 15, 1993 [hereinafter Clinton Memorandum] (on file with Graduate School of Business, Texas A&M University). For general background on the Clinton Administration proposals, see Kenneth H. Bacon, Clinton Wins Support for More Loans to Poor Areas, but Plan Faces
ton Administration's December 21, 1993 proposed CRA regulations. Part I first advances general hypotheses derived principally from these articles regarding possible relationships between the CRA and depository institution makeup. Part I then presents an overview of study methodology. Next, Part II examines and analyzes these hypotheses in light of our preliminary empirical data. Finally, Part III presents an overall policy review, including an analysis of the new proposed regulations, in view of our empirical data. It is hoped that these findings will be helpful in enlightening the debate regarding the CRA begun by Professors Macey, Miller, and Swire, and continuing among policy makers in Washington.

I. The CRA and Depository Institution Makeup

A. Overview

In their article, Professors Macey and Miller set forth a number of general hypotheses regarding possible relationships between CRA ratings and depository institution makeup. Since the Act requires regulators to take CRA performance into account whenever a depository institution makes an application to acquire another depository facility, Professors Macey and Miller posit that large banks interested in establishing new branches or acquiring other banks will likely have relatively high CRA ratings. Similarly, they posit that "wholesale" (as opposed to "retail") banks primarily engaged in corporate banking, depository institutions that emphasize trust services, and depository institutions with conservative investment strategies holding large percentages of loans in marketable securities will have relatively low CRA ratings. They also speculate that institutions with a lot of "risky" CRA loans may be "sacrificing profit," which implies institutions with high CRA ratings may have lower net interest income and profits.

While Professor Swire does not explore these potential interrelationships as extensively as Professors Macey and Miller, he does assert


34. Macey & Miller, supra note 1, at 315.
35. Id. at 316-18.
36. Id. at 319-22.
that small banks are less likely to have high CRA ratings than large banks. He notes that small banks “lack specialized personnel and other economies of scale” of a kind that would enable them to obtain high CRA ratings. He further suggests a high CRA rating may generally be less important to smaller depository institutions because they are less likely to be the target of CRA protests than large banks and are less likely to apply for branch openings or mergers than their larger counterparts. In developing his safe harbor proposal, Professor Swire also appears to imply agreement with Professors Macey and Miller’s assertion that at the present time it is difficult for institutions pursuing “niche” strategies (such as wholesale banking) to obtain high CRA ratings.

The application of basic economic analysis also points to various potential interrelationships in this area. Agency theory, for example, would hypothesize that managers of a business would be less concerned about “sacrificing profits” to CRA activities (and perhaps more concerned about good public relations) than owners. Consequently, one might expect publicly traded depository institutions with widely diffused ownership to have higher CRA ratings than nonpublicly traded institutions, which are often family-dominated. Also, since the Douglas Amendment to the Bank Holding Company Act of 1956 is the principal legal basis enabling banks to engage in interstate acquisition activity, one would probably expect institutions that are part of such bank holding companies to have higher CRA ratings than institutions not so organized (especially given the need for acquiring institutions to have high CRA ratings). These and other hypotheses are empirically tested below.

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37. Swire, supra note 2, at 352 n.9.
38. Id.
39. See, e.g., Texas Commerce Sets Asset Sale to Meet Antitrust Objections, WALL ST. J., Feb. 12, 1993, at A3 (stating that the Comptroller of the Currency had delayed approval of a bank’s proposed acquisition in order to investigate CRA complaints it had received).
40. Swire, supra note 2, at 352 n.9.
41. See id. at 354.
44. For a discussion of bank holding company interstate acquisition versus interstate branching, see Leonard Bierman & Donald R. Fraser, The Canada-United States Free
B. Methodological Overview and Preliminary Hypotheses

We explored the relationship between CRA ratings and the characteristics of individual banks with the use of a database developed from the FDIC data tapes on the financial condition of individual commercial banks. These tapes provide balance sheet and income statement data on every insured commercial bank in the United States for each quarterly reporting period. For ease of analysis, our study uses balance sheet data as of the end of 1990 and income statement data for the year 1990.

Numerous variables were constructed from this data for the over 4,000 commercial banks for which CRA rating data were available. Among the variables constructed were:

1. Total Loan Ratio, defined as the dollar amount of total loans for the bank at year end divided by the dollar amount of total assets. To the extent that the CRA encourages banks to make loans in their community, it would be expected that banks with higher loan ratios should have better CRA ratings.

2. Residential Loan Ratio, defined as the dollar amount of total loans secured by one- to four-family residences divided by total assets. As with variable (1), banks with higher residential loan ratios should have better CRA ratings. Given the recent focus on providing residential loans in a nondiscriminatory manner, this relationship should be especially strong.

3. Consumer Loan Ratio, defined as the dollar amount of loans to individuals divided by total assets. As with the residential real estate loans, high CRA ratings should be found in banks with a comparatively high amount of consumer loans.

4. Multifamily Loan Ratio, defined as the dollar amount of loans on income-producing residential property other than one- to four-family residences divided by total assets. This was developed because other dimensions of the mix of loans may be important in influencing the CRA rating. The a priori expectation for the relationship between this variable and the CRA rating is not entirely clear. To the extent that making more loans is perceived by the regulators as positive, then high CRA ratings should accompany high multifamily loan ratios. This would be particularly true if some of these loans are for...
low-income or other kinds of housing that would tend to be viewed favorably under the CRA. However, some of these loans may be out-of-territory, and some may also be wholesale rather than retail in nature. These possibilities may cause regulators to perceive them as harmful to the CRA effort, and thereby result in lower CRA ratings.

(5) **Marketable Security Ratio**, defined as the ratio of the dollar amount of holdings of marketable-investment securities divided by total assets. As discussed above and developed by Professors Macey and Miller, it is hypothesized that the larger a bank's marketable security ratio, the worse will be its CRA rating.

(6) **Other Bank Performance Ratios.** Since there may be a relationship between the manner in which examiners assign a CRA rating and the overall performance of a bank (i.e., because the CRA rating and the regulatory “safety and soundness” rating may be correlated), two performance measures were examined: (a) **Net Interest Income Ratio**, defined as the difference between interest revenue and interest expense divided by the total assets; and (b) **Loan Loss Provision Ratio**, defined as the amount of the expense item “provision for loan losses” divided by total assets. We hypothesize, as did Professors Macey and Miller, that the lower-profitability banks should have better CRA ratings, since these banks have adopted suboptimal portfolios in order to conform to CRA requirements.

The following three important variables were developed in order to focus on the CRA hypotheses previously discussed:

(7) **Trading Status**, defined as “1” if the bank issued publicly traded stock and as “0” if it did not. The hypothesis, as discussed above, is that, pursuant to agency theory, managers of publicly traded banks are more likely to make portfolio adjustments that produce better CRA ratings. Those banks are more visible (and gener-

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46. See Macey & Miller, *supra* note 1, at 318; text accompanying note 25.
47. Every federally insured commercial bank is evaluated annually on the basis of its safety and soundness, using a CAMEL rating system. Under this system, the institution is assigned a rating of 1 (best) to 5 (worst) based upon its Capital, Asset quality, Management, Earnings, and Liquidity. See Mona Gardner & Dixie Mills, *Managing Financial Institutions* ch. 2 (1992).
49. Macey & Miller, *supra* note 1, at 319-22.
50. See *supra* note 42 and accompanying text.
ally larger) than banks that are not publicly traded, and shareholder ownership is generally more widely diffused.\textsuperscript{51}

(8) \textit{Holding Company Status}, defined as “1” if the bank is part of a multibank holding company and as “0” if it is not. As noted above,\textsuperscript{52} banks that are part of a multibank holding company can more easily acquire other banks pursuant to the Bank Holding Company Act, and thus are more likely to be part of organizations that have engaged in or will engage in acquisitions. Since regulators take CRA ratings into account in approving such acquisitions, it would be expected that banks affiliated with multibank holding companies are more likely to take action aimed at achieving high CRA ratings.

(9) \textit{Number of affiliates}, measured as the number of banks that are part of the banking organization. For banks not affiliated with a holding company or for one-bank holding companies, this number is “0.” Like the previous variable, the number of affiliates can be seen as a proxy for acquisition activity. It would be expected that those banks that are part of large bank holding companies (measured in terms of number of affiliates) would be most likely to take actions to obtain good CRA ratings.

\section*{II. Empirical Results}

\subsection*{A. Univariate Analysis}

Table One\textsuperscript{53} presents the means for the variables gathered on the banks in the study. For each variable the mean is provided for all banks with high CRA ratings (“outstanding” or “satisfactory”) taken as a group, and separately for all banks with low CRA ratings (“needs to improve” or “substantial noncompliance”) taken as a group.\textsuperscript{54}

\textsuperscript{51} For example, Citicorp, the nation’s largest bank, has $217 billion in assets and approximately 64,000 common shareholders. Telephone Interview with Peter Bryan, Citicorp Investor Relations (Aug. 9, 1993).

\textsuperscript{52} See supra notes 43-44 and accompanying text.

\textsuperscript{53} All of the tables are found infra in the Appendix.

\textsuperscript{54} We have also computed, in Table Two, the means for banks at the extremes of the CRA ratings distribution, i.e., banks with 1 (outstanding) ratings versus banks with 4 (substantial noncompliance) ratings. A comparison of these means provides evidence that is generally consistent with that in Table One.

As in Table One, although it appears that banks rated “outstanding” do make more loans than banks rated as being in “substantial noncompliance,” the difference is not statistically significant. Banks rated “outstanding” do, however, make statistically significant larger amounts of single-family residential and multifamily residential loans than banks with the lowest CRA ratings. Similar to the results in Table One, the highest-rated banks had statistically significant lower net interest income than the lowest-rated banks, and the lowest-rated banks had significantly higher provisions for loan loss reserves than the high-
addition, a "t" test for the statistical significance of differences is conducted and those differences that are significant at the one percent level or the five percent level are indicated by asterisks.55

An examination of the means of financial performance ratios as shown in Table One suggests limited but important differences between banks with high and low CRA ratings. For example, while banks with high CRA ratings appear to make more loans than banks with low CRA ratings (a loan-asset ratio of 52.97% for high-rated banks versus 51.47% for low-rated banks), the differences between the two means is not statistically significant. The data also suggest the loans high-rated banks make are not riskier than those made by banks with lower CRA ratings. This is because banks with high CRA ratings have, on average, provisions for loan losses that are less than those with low CRA ratings.56 These data seem to cut against Professors Macey and Miller's assertions that the CRA may force banks to make risky (i.e., "bad") loans.57

Table One also shows that banks with high CRA ratings have statistically significant lower net interest income than banks with low CRA ratings. The lower net interest income earned by banks with high CRA ratings may have the effect of removing significant amounts of capital from bank lending capacity. More simply put, money that is not earned is generally not available to be lent out to other individuals. Thus, quite ironically, high bank CRA ratings may in a sense work to harm communities in which these banks are located because these banks have less funds available for lending in the community. Consequently, as Professors Macey and Miller point out in their article,58 and as Professor Macey has forcefully emphasized in a

55. The "t" test indicates whether the samples come from the same population. If, for example, the difference between the means is statistically significant at the 1% level, it means that the chances are 99% that the samples come from two different populations. In other words, the chances are 99% that the difference in ratios actually corresponds to a difference in behavior. See Eric A. Hanushek & John E. Jackson, STATISTICAL METHODS FOR SOCIAL SCIENTISTS 122-24, 336-37, 363 (1977). Those values without an asterisk are not statistically significant at the 1% or 5% level. This does not mean that these values are statistically insignificant—it merely means that they are significant at a level of greater than 5%.

56. This difference is statistically significant at the 1% level. See supra note 55.

57. See Macey & Miller, supra note 1, at 319-22, 324.

58. Id. at 340-41.
more recent “op-ed” article, the CRA’s impact on local communities is not necessarily a positive one.

In addition, given the apparent possible magnitude of lost earnings, the lack of strong bank shareholder criticism regarding high degrees of CRA compliance seems puzzling. Our data suggest that “agency theory” may offer a partial explanation. Banks with high CRA ratings are almost twice as likely to be publicly traded as banks with low CRA ratings. Such publicly traded institutions generally have widely diffused ownership, with lost profit opportunities being spread amongst numerous, often geographically dispersed individuals. These dispersed owners may have difficulty closely monitoring bank managers, who may own relatively little equity in the bank, and who may put a high value on achieving a positive reputation for the bank (and perhaps derivatively for themselves). One way for bank managers to achieve such positive reputations is to earn high bank CRA ratings, which is accomplished by investing in “CRA-positive” activities.

In contrast, nonpublicly traded banks are frequently smaller institutions (our data show that banks with lower CRA ratings are, on

59. Macey, supra note 16.
60. See infra Table One.
61. See generally Jensen & Meckling, supra note 42; Eugene F. Fama & Michael C. Jensen, Separation of Ownership and Control, 26 J.L. & ECON. 301 (1983) (discussing the survival of organizations in which agents responsible for important decisions do not bear a substantial share of the wealth effects of their decisions).
63. See Value Line Investment Survey, June 11, 1993, at 2001-44 (outlining “inside ownership” at leading United States banks, many of which had less than two percent of their shares owned by “insiders”). See generally Jennifer Reese, Buy Stock—or Die, Fortune, Aug. 23, 1993, at 14 (stating that an increasing number of companies are forcing their executives to buy stock in order to be sure the executives behave in the best interest of the shareholders).
64. In the economics literature, this is referred to as the “expense preference” problem. The idea is that managers, to increase their own utility, may incur expenditures that go beyond the optimal amount from a shareholder perspective. See Oliver E. Williamson, Managerial Discretion and Business Behavior, 53 AM. ECON. REV. 1032 (1963) (the classic article on the subject). For discussions of this phenomenon in the context of the banking industry, see Franklin R. Edwards, Managerial Objectives in Regulated Industries: Expense-Preference Behavior in Banking, 85 J. POL. ECON. 147 (1977); Timothy H. Hannan & Ferdinand Mavinga, Expense Preference and Managerial Control: The Case of the Banking Firm, 11 BELL J. ECON. 671 (1980); Peter S. Rose, The Changing Structure of American Banking 42-44 (1987). See generally Loretta J. Mester, Owners Versus Managers: Who Controls the Bank?, FEDERAL RESERVE Bd. PHILA. BUS. REV., May-June 1989, at 13, 17 (discussing desires of bank managers to enhance their own “reputations” and to engage in “upward window dressing” on behalf of the bank).
65. See generally Macey & Miller, supra note 1, at 330-33.
average, significantly smaller in terms of total assets than highly rated banks\textsuperscript{66}) with far more concentrated ownership; indeed, such banks are frequently owned or controlled by a single family.\textsuperscript{67} In such banks, family members also serve in management roles and, in any event, the owners of such banks can be expected to supervise closely the activities of the bank's managers.\textsuperscript{68} Under such conditions, bank owners probably will not permit bank managers to sacrifice earnings beyond an optimal level in order to achieve enhanced reputational effects (\textit{i.e.}, there are no "agency" problems).\textsuperscript{69} In such a situation, bank owners likely will see the relationship between overspending on CRA activities and lost profits.\textsuperscript{70} Thus, it is not at all surprising that nonpublicly traded banks have lower CRA ratings than publicly traded banks.

Finally, our Table One data also preliminarily suggest the possibility of considerable subjectivity in the assignment of CRA ratings by regulatory authorities. Banks with high CRA ratings make only slightly more loans than banks with low CRA ratings, and indeed banks with low CRA ratings actually make more "consumer loans" than banks with high ratings.\textsuperscript{71} Moreover, as noted above,\textsuperscript{72} banks with high CRA ratings have, on average, a higher percentage of their assets in marketable-investment securities than banks with low CRA ratings.\textsuperscript{73} Thus, the data do not seem to indicate that the banks being assigned high CRA ratings are uniformly those that actively put overwhelming percentages of their assets to work helping consumers in their communities.

These data thus seem to directly support Professor Swire's contentions regarding the vagueness and subjectivity of the CRA evaluation standards, and the consequent compliance burden these standards place on depository institutions.\textsuperscript{74} Moreover, the data support the notion discussed above,\textsuperscript{75} that the CRA evaluation standards as currently constructed afford regulatory authorities wide-ranging

\textsuperscript{66}. See \textit{infra} Table One.
\textsuperscript{67}. See Rose, \textit{supra} note 64, at 40-41.
\textsuperscript{68}. \textit{Id.} at 43; see also Mester, \textit{supra} note 64, at 16.
\textsuperscript{69}. Again, in such situations, bank managers and owners may actually be one and the same. See Ross, \textit{supra} note 64, at 43.
\textsuperscript{70}. There will be not be any "expense preference" problem as there might be at larger banks. \textit{Id.}
\textsuperscript{71}. \textit{Id.}
\textsuperscript{72}. See \textit{supra} note 26 and accompanying text.
\textsuperscript{73}. See \textit{infra} Table One.
\textsuperscript{74}. See Swire, \textit{supra} note 2, at 349-56.
\textsuperscript{75}. See \textit{supra} notes 11-15, 28-30 and accompanying text.
power and discretion. Indeed, in his July 15, 1993 testimony before the United States Senate Banking Committee explaining the Clinton Administration's proposals for reforming the CRA, Comptroller of the Currency Eugene A. Ludwig stated that "the standards against which examiners currently judge CRA performance are unclear and subjective," and they lack "credibility." Thus, as will be discussed below, one of the major thrusts of the Clinton Administration proposals for the CRA is to have clearer and more quantifiable CRA assessment standards in order to reduce "regulatory uncertainty."

B. Multivariate Analysis

While these comparisons suggest some differences between the high-rated banks and the low-rated banks, such comparisons are limited in their usefulness because they do not consider the joint effects of all the different variables simultaneously on the CRA ratings. It is quite possible, for example, for a variable to be insignificant in its effect on the CRA within this framework, but to have a significant influence on the CRA once the effects of other factors are taken into account. Controlling the effects for the potential influence of these other factors requires a multivariate analysis, the results of which are presented in Table Three. This analysis was performed with the use

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76. See generally Cass & Gillette, supra note 30, at 320-25 (arguing that regulators are often interested in maximizing their own sphere of influence and objectives).

77. Testimony of Eugene A. Ludwig, Comptroller of the Currency, before the Senate Committee on Banking, Housing, and Urban Affairs, July 15, 1993 [hereinafter Ludwig Testimony] (on file with Graduate School of Business, Texas A&M University).

78. Id.

79. See infra Part III.B.1.

80. Clinton Memorandum, supra note 31.


82. The logistic regression results of Tables Three and Four are presented as coefficients. The interpretation of these coefficients is explained best by example: In Table Three, the coefficient of loans for Model 1 is 1.5319. This means that a 1% increase in the loans to assets ratio increases the probability by 4.63 times, \( \exp(1.5319) \), that the bank would be classified as a complying bank. For a more detailed treatment of logistic regressions and the interpretation of coefficients, see David W. Hosmer, Jr. & Stanley Lemeshow, Applied Logistic Regression 38-81 (1989).
of a Logit regression model. The results of the analysis are highly consistent with those in the univariate analyses.

Table Three shows that, holding all other variables constant, banks with high CRA ratings make significantly more overall loans than banks with low CRA ratings. However, the data do not show that the greater number of loans made by banks with high CRA ratings was statistically significant in the two areas in which they might intuitively be expected to be making more loans—consumer loans and single-family residential loans. Moreover, the logistic regressions clearly show that banks with low CRA ratings make significantly more multifamily (e.g., apartment building) loans than do banks with high CRA ratings. While some multifamily loans may be purely commercial in nature, others may well be for low-income or other sorts of housing that should be viewed positively for CRA rating purposes. In addition, as in the univariate analysis, banks with high CRA ratings have more of their assets in marketable-investment securities than banks with low CRA ratings. This result is counterintuitive and lends further support to the view that the CRA ratings assigned by regulators may have a strong "subjective" element to them.

Another important finding in Table Three, again consistent with the univariate analysis, is that there is an inverse relationship between bank net interest income, a measure of bank profitability, and bank CRA rating. Banks with low CRA ratings have statistically significant (at the one percent level) higher net interest income than banks with high CRA ratings. Thus, complying with the CRA ap-

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83. Unlike the ordinary least squares (OLS) regression model (which requires that the dependent variable theoretically can take any value from negative to positive infinity), the Logit model can handle categorical or dichotomous dependent variables, and yet retain the other desirable properties of the OLS model. In this analysis, the dependent variable was defined as "1" if the CRA rating was a 1 (outstanding) or 2 (satisfactory) and "0" if it was 3 (needs improvement) or 4 (unsatisfactory). Of the sample 4,365 banks, 3,981 were classified as a "1" (with a CRA rating of 1 or 2) and 384 banks were classified as a "0" (with a CRA rating of 3 or 4). A substantial number of logistic regressions were estimated with different combinations of the variables. Four of these equations are presented in Table Three. See generally id. at 187-203, 212-14.

84. As with the univariate analysis, an analysis was also conducted of the extremes of the distribution, i.e., banks with the highest, or "outstanding," ratings as opposed to those with the lowest, or "unsatisfactory," ratings. These logistic regression results are presented in Table Four. The results of these analyses are consistent with those presented in Table Three.

85. See infra Table One.
86. See infra Table Three.
87. See infra Table One.
88. See infra Table Three.
pears to come at a cost to bank shareholders.\footnote{98} Also consistent with
the univariate analysis,\footnote{99} banks with high CRA ratings are not found
in the logistical regressions to take higher provisions for loan losses
than low-rated banks.\footnote{100}

Moreover, the logistical regressions conform with the univariate
analysis regarding publicly versus nonpublicly traded bank status.\footnote{101}
The data show a strongly significant relationship between high CRA
ratings and publicly traded status.\footnote{102} The fact that banks with high
CRA ratings are significantly more likely to be publicly traded, and
that these same banks are significantly more likely to have lower net
interest income than their low-rated counterparts (holding all other
variables constant under logistical regressions) tends to lend further
credence to the "agency theory" hypothesis regarding banks and CRA
ratings advanced above.\footnote{103} Finally, the logistical regressions found
high-rated banks to be significantly more likely to be part of a holding
company, and to have more numerous affiliates, than banks with low
CRA ratings.\footnote{104} These results are fully consistent with the hypotheses
advanced by Professors Macey and Miller\footnote{105} and Professor Swire (in
the context of his "safe harbor" proposal)\footnote{106} that banks interested in
making acquisitions and otherwise expanding are more likely to have
higher CRA ratings.\footnote{107}

In sum, the logistical regressions are quite consistent with the
univariate analyses conducted. Both sets of results show the follow-
ing: First, high-rated banks make more overall loans than low-rated
banks, but there is no clear evidence that the loans they make directly
serve the community. Indeed, low-rated banks may in some instances
make more loans of this kind. Second, contrary to what might be gen-
eral intuition and contrary to the general assertions by Professors Ma-

\footnote{98}{It may also come at a cost to bank creditors and customers. \textit{See infra} note 161 and
accompanying text.}
\footnote{99}{\textit{See infra} Table One.}
\footnote{100}{\textit{See infra} Table Three. One problem with examining loan loss provisions is that
banks are notorious for manipulating their loan loss provisions in order to "smooth" earn-
ings. \textit{See} Christopher K. Ma, \textit{Loan Loss Reserves and Income Smoothing: The Experience
\footnote{101}{\textit{See infra} Table Three.}
\footnote{102}{\textit{Id.}}
\footnote{103}{\textit{See supra} notes 60-70 and accompanying text.}
\footnote{104}{\textit{See infra} Table Three.}
\footnote{105}{\textit{See Macey \& Miller, supra} note 1, at 302-03.}
\footnote{106}{\textit{See} Swire, \textit{supra} note 2, at 351-57.}
\footnote{107}{The data use bank holding company status and number of affiliates as proxies for
expansion activity.}
Macey and Miller in this regard, banks with high CRA ratings have more of their assets in marketable-investment securities than low-rated banks. Third, banks with high CRA ratings have significantly lower net interest income than banks with low CRA ratings. Fourth, banks with high CRA ratings are significantly more likely, even holding all other variables including size constant, to be publicly traded than low-rated banks. Finally, banks with high CRA ratings are more likely to be oriented toward expansion and acquisition, at least to the extent that holding company status and number of affiliates serve as adequate proxies for these activities.

III. Policy Implications of Data

A. Overview

The most troubling problem in the administration of the CRA pointed out by the empirical data is the apparent subjectivity involved in the awarding of ratings. Banks with high CRA ratings do not appear to make more consumer loans or single-family residential loans than banks with low CRA ratings. In fact, banks with high CRA ratings appear to have greater amounts of assets in marketable-investment securities than banks with low CRA ratings. Given these appearances, one must question the real bases on which CRA ratings are being assigned. Any proposal for reform in this area must address this issue.

Moreover, the empirical data supports Professors Macey and Miller's contention that the CRA represents a direct and arguably discriminatory "tax" on depository institutions that comply with its mandates. Banks with favorable CRA ratings have significantly lower net interest income than those with poor ratings, and show other indicia of lower profitability. This finding raises troubling issues regarding enforcement of the statute, since organizations appear to have incentives to "cheat" and get away with low compliance. The empirical evidence indicates that nonpublicly traded institutions are

99. See Macey & Miller, supra note 1, at 317-18.
100. Id. at 312-13.
101. See infra Tables One and Three.
102. The univariate analysis of Table One also showed larger loan loss provisions for high-rated banks, although the empirical results with respect to this issue have not been consistent. Compare Table One with Tables Two & Three. Possible "manipulation" of these provisions by bankers may be a factor. See Ma, supra note 91.
103. See generally infra notes 166-167 and accompanying text (stating that taxation by regulation is difficult to enforce and that organizations often have incentive not to comply).
among those most likely to cheat, and managers of publicly traded institutions are much more likely to comply with the CRA. Of course, the empirical results are entirely consistent with "agency theory," given that bank managers are not as directly affected by lost profits as bank owners. However, given that publicly traded (and generally larger) banks tend to comply with the CRA, these institutions seem to be at a competitive disadvantage vis-à-vis brokerage houses like Merrill Lynch and other enterprises that increasingly offer banking services without being subject to the mandates of the CRA.

Thus, the CRA creates an "unlevel playing field" in the financial services industry. Professor Macey has strongly criticized this effect:

[B]anks are no longer an appropriate medium for transferring political patronage.

Historically, the banking industry was a heavily regulated, highly protected cartel. In exchange for banks' willingness to be used in ways convenient to politicians, they earned the monopoly profits enjoyed by cartels.

But the banking cartel has steadily broken down in recent years, with the entry of unregulated firms. Mutual funds, insurance companies, commercial finance companies, investment banks and pension funds all compete directly with banks but do not have to comply with inefficient regulations that restrict bank activities and impede profitability.

For banks, these regulations include ... above all, the Community Reinvestment Act. The CRA is the single most costly regulation imposed on an industry being consumed by regulation.

Our empirical data support this assertion. The CRA places banks at a competitive disadvantage versus other financial intermediaries. Thus, any CRA reform effort must address this issue.

104. See infra Tables Three and Four.
105. This is supported by the empirical results even when confounding factors such as bank size are held constant under logistic regression analyses. See infra Tables Three and Four.
106. See supra note 42 and accompanying text.
108. See Macey & Miller, supra note 1, at 312-13.
109. Id.
110. Macey, supra note 16.
B. The Clinton Administration’s CRA Proposals

(I) Overview

On July 15, 1993, President Clinton issued a memorandum regarding the CRA to the Comptroller of Currency, the Acting Chairperson of the FDIC, the Chair of the Board of Governors of the Federal Reserve System, and the Acting Director of the Office of Thrift Supervision.\textsuperscript{111} In the memorandum, the President stated his belief that “the CRA’s full potential remains unrealized,” and the statute’s “implementation has focused too much on documentation and process, and not enough on actual performance.”\textsuperscript{112} The President also pointed out that while CRA evaluation standards cannot be totally objective, banks and thrifts are entitled to “clearer guidance as to how the regulatory agencies will evaluate CRA performance.”\textsuperscript{113} To this end, he instructed the four above-named regulators to work with others in developing a new set of CRA regulations that will “reform the CRA enforcement system by replacing paperwork and uncertainty with greater performance, clarity, and objectivity.”\textsuperscript{114}

On December 21, 1993, the aforementioned regulators released for notice and comment proposed regulations for reform of the CRA.\textsuperscript{115} The thrust of these proposed regulations is to rate financial institutions with respect to the CRA based on their “actual performance” in meeting community credit needs, as opposed to the rather vague and subjective criteria currently being used.\textsuperscript{116} To this end, the proposal outlines a variety of new procedures.

First, under the proposed regulations, banks would be directly examined with respect to their lending practices and the makeup of their loan portfolios.\textsuperscript{117} More specifically, regulators would compare the amount of loans\textsuperscript{118} the bank or thrift was making to low and moderate areas in its service area to the amount of loans it was making in its overall service area.\textsuperscript{119} Institutions whose market share of low to

\textsuperscript{111} Clinton Memorandum, \textit{supra} note 31.
\textsuperscript{112} Id.
\textsuperscript{113} Id.
\textsuperscript{114} Id. Testifying before the U.S. Senate Banking Committee on July 15, 1993 regarding the President’s CRA initiative, Comptroller of Currency Eugene Ludwig emphasized the unclear and subjective nature of the current CRA evaluation process, and the need for more performance-based standards. \textit{See} Ludwig Testimony, \textit{supra} note 77.
\textsuperscript{116} Id.
\textsuperscript{117} Id.
\textsuperscript{118} Different types of loans may be evaluated differently. \textit{Id.} at 67,469.
\textsuperscript{119} \textit{Id.} at 67,469-70.
moderate income area loans exceeded its market share of other loans would be strong candidates for an "outstanding" rating in this regard. Conversely, institutions whose market share of loans in low to moderate income areas was less than its overall market share of loans would be in danger of being assigned a rating of "substantial noncompliance" or "needs to improve".

Similar performance-based evaluations are also to be conducted with respect to financial institution "investment" and "service" activities. For example, under the "service" component, regulators will, among other things, examine the percentage of branches an institution has that are "located in or readily accessible to low- and moderate-income geographies in its service area." Institutions with few branches in such areas will likely receive "needs to improve" or substantial noncompliance ratings on this component.

One major change in the proposed regulations is that of potentially streamlined CRA evaluation procedures for financial institutions with total assets under $250 million. The proposed regulations appear to provide such institutions with a presumptive "satisfactory" rating if they meet a relatively high loan-to-deposit ratio. The regulatory language seems to imply a sixty percent cutoff, i.e., if at least sixty percent of their deposits are being loaned to customers, there would be a presumptive "satisfactory" rating.

The proposed regulations also give financial institutions the option, in lieu of the above-mentioned evaluatory schemes, to be evaluated by regulators on the basis of a CRA strategic plan they have developed. Such plans must state measurable CRA goals against which "subsequent performance would be assessed." Plans of this

121. See id.
122. See id.
123. Id. at 67,471.
124. Id.
125. This includes banks and thrifts that are independent institutions with assets of less than $250 million or institutions with less than $250 million in assets that are members of holding companies with total assets of less than this amount. See 58 Fed. Reg. 67,472 (1993).
126. Id.
129. Id.
kind would be subject to public disclosure and comment before receiving even initial regulatory approval.\textsuperscript{130}

In developing the proposed CRA regulations, the Federal Reserve Board, the Comptroller of Currency, the FDIC, and the Office of Thrift Supervision explicitly considered and rejected "safe harbor" proposals of the kind suggested by Professor Swire.\textsuperscript{131} The regulators noted that during public hearings on the regulations, groups "outside the banking community" expressed strong opposition to any sort of "safe harbor" approach based on CRA regulatory agency ratings.\textsuperscript{132}

Moreover, the proposed regulations do not address the application of the CRA to "nonbank" financial institutions.\textsuperscript{133} Under the proposed regulations, mutual funds, brokerage houses, and other nonbank financial intermediaries would continue to be exempt from the CRA.

(2) \textit{Analysis}

The Clinton Administration's proposed CRA regulations directly address the problem of subjectivity in the current awarding of CRA ratings, a problem made clear by our empirical data.\textsuperscript{134} Moreover, regulators in developing these regulations expressed sensitivity to the fact that these new regulations, while more "objective in nature, should not be formulaic."\textsuperscript{135} Nevertheless, the proposed market-share lending ratios are indeed quite "formulaic" in nature, and have been criticized by financial institution representatives in this regard.\textsuperscript{136}

The proposed streamlined CRA procedures for financial institutions with under $250 million in total assets are interesting from a number of perspectives. Both Professors Macey and Miller\textsuperscript{137} and Professor Swire\textsuperscript{138} have posited that such smaller banks are likely to have lower CRA ratings than larger banks, a hypothesis supported by our empirical data.\textsuperscript{139} In addition, such smaller banks frequently are not publicly traded,\textsuperscript{140} and our empirical data show that nonpublicly

\textsuperscript{130.} Id.
\textsuperscript{132.} See \textit{id}.
\textsuperscript{133.} \textit{See Regulators, Bankers Discuss Proposed CRA Rule Changes, Sav. \& Community Bankers Am., Wash. Persp.,} Feb. 7, 1994, at 3 [hereinafter Bankers' Reactions].
\textsuperscript{134.} See \textit{infra} Tables One and Three.
\textsuperscript{135} See \textit{infra} Tables One and Three.
\textsuperscript{136.} See Bankers' Reactions, supra note 133.
\textsuperscript{137.} See Macey \& Miller, supra note 1, at 315.
\textsuperscript{138.} See Swire, supra note 2, at 351-52 n.12.
\textsuperscript{139.} See \textit{infra} Tables One \& Three.
\textsuperscript{140.} See Rose, supra note 64, at 40-41.
traded institutions tend to have lower CRA ratings than publicly traded institutions. As developed above, this is consistent with "agency theory," with smaller banks frequently having considerable incentives to "cheat" with respect to CRA compliance.

The proposed regulations, while potentially "streamlined" in terms of paperwork for small banks, also represent a much stricter scheme of enforcement. In order to qualify for such streamlined CRA review, small banks may have to meet a sixty percent loan-to-deposit ratio. However, during the past decade, many small banks failed because of loan portfolio problems. This, along with a desire to avoid problems with regulators concerned about potential future FDIC insurance fund liabilities, has made many small banks extremely conservative about making loans, in some cases maintaining loan-to-deposit ratios of approximately thirty percent. In some regions of the country, the average loan-to-deposit ratio for all commercial banks is presently less than sixty percent. Under the proposed CRA regulations, though, such loan-to-deposit ratios might not qualify banks for streamlined CRA review, and indeed would make them somewhat suspect in the case of regular CRA review. Thus, small bankers will likely find themselves under pressure to be conservative in their lending to avoid possible loan losses and failure, and generous in their lending in order to meet the sixty percent loan-to-deposit ratio for simplified CRA examinations and favorable CRA ratings. Because this puts small banks in a catch-22 situation, reaction to the proposed small bank CRA regulations has been strongly in favor of a

141. See infra Tables One and Three.
142. See supra notes 60-70 and accompanying text.
147. See FDIC Quarterly Banking Profile, Third Quarter, 1993, at 4 (indicating new loans- and losses-to-deposits ratio of 56.67% for all commercial banks in the southwest region of the United States).
more "flexible" test than that of a fixed sixty percent or other relatively high ratio.\textsuperscript{148}

The loan portfolio issues likely to be faced by small bankers under the proposed regulations are also ones larger financial institutions are likely to confront, albeit in a more general way. Regulators have told financial institutions that the regulators do not, under the proposed CRA regulations, expect financial institutions "to sacrifice safety and soundness standards to make any loan," and that the financial institutions should look at the proposed regulations in terms of "new business opportunities" as opposed to "burden and cost."\textsuperscript{149} Nevertheless, the whole thrust of the proposed regulations, as banking executives have noted,\textsuperscript{150} is on meeting loan portfolio market share ratios. Conservative lenders will likely find it even harder under the new regulatory regime to achieve high CRA ratings. If they are interested in expanding, however, they will need high CRA ratings lest regulators block such activities on CRA grounds, as they have been doing with greater frequency.\textsuperscript{151} Thus, conservative institutions can be expected to breach their normal, highly-conservative lending standards in order to fall into good graces with the CRA regulators (i.e., pay a CRA "tax"\textsuperscript{152}).

Moreover, large financial institutions are likely to continue to be in direct competition for consumer funds with mutual funds and other financial intermediaries that are not subject to the CRA. Over the past decade, bank share of consumer deposit funds has shrunk from eighty-four percent to fifty-four percent, while the share of such monies in mutual funds has risen from approximately sixteen percent to

\textsuperscript{148} See Bankers' Reactions, supra note 133.

\textsuperscript{149} See Letter from Jonathan L. Fiechter, Acting Director, Office of Thrift Supervision, Department of Treasury, to Chief Executive Officers of Savings Associations (Dec. 21, 1993), at 3 (on file with Graduate School of Business, Texas A&M University).

\textsuperscript{150} See Bankers' Reactions, supra note 133.


\textsuperscript{153} See generally Macey & Miller, supra note 1, at 318-24 (discussing the "safety and soundness" implications of the CRA).
The proposed CRA regulations, much to the expressed consternation of banking executives, do not expand CRA application to mutual funds or other nonbank financial intermediaries. Reform of this kind seems worthy of careful consideration.

C. Taxation by Regulation

In a 1971 article entitled *Taxation by Regulation*, Professor (now Judge) Richard A. Posner noted that "one of the functions of regulations is to perform distributive and allocative chores usually associated with the taxing or financial branch of government." Professor Posner argued that regulatory "taxation" has a number of positive and negative attributes, and went on to develop a comprehensive framework for analyzing regulation of this kind. While Professors Macey and Miller explicitly refer to the CRA as a "tax" on depository institutions, neither they nor Professor Swire incorporate Professor Posner's analytical framework in their discussions of the CRA. Nevertheless, Professor Posner's analytical model regarding taxation by regulation appears to provide an unusually useful approach for examining and evaluating the CRA.

Posner, discussing the long history of regulations requiring privately owned firms to provide services "an unregulated competitive market would not provide on the same scale," points out when "a service is provided that does not pay its way in the market," someone ultimately "must pay its way." He argues that stockholders, creditors, and customers of the firm will end up bearing this cost. He states such regulation "alters normal business incentives" and it can be viewed as an exertion (via regulatory agencies) of "state power whose purpose, like that of other taxes," is to compel support of a

157. Id. at 41-47.
158. Macey & Miller, supra note 1, at 312-13.
159. Professors Macey and Miller do, however, develop the notion that the CRA represents regulatory taxation. Id. at 343.
161. Id. Firm employees may also end up bearing these costs.
162. Id. at 27.
"service that the market would provide at a reduced level, or not at all." Moreover, Posner notes that the ability of regulatory agencies to "control entry" into the field is an important adjunct to such regulation. Otherwise, firms not burdened with the costs of providing these services will be able to enter the markets and compete on a more effective basis.

Posner also states that an "important characteristic of taxation by regulation is difficulty (and expense) of enforcement." He notes the "tendency of regulated firms to cheat in providing unremunerative services," and the likelihood that privately held companies will probably "resist providing unremunerative services more energetically" than publicly owned ones.

Nevertheless, Posner debunks the criticism of taxation by regulation, stating that while taxation by regulation "distorts the efficient allocation of resources," and is "arbitrary" and "inequitable," all methods of taxation are distortive, and there is no reason to assume that taxation of this kind is any more distortive, arbitrary, or inequitable than any other form of taxation. Indeed, he argues that there may be numerous equitable and administrative advantages to taxation by litigation. The one major problem with taxation of this kind, however, is it has such "low visibility" that it frequently escapes public scrutiny. Posner strongly recommends greater public visibility for such tax subsidies and, when possible, "the amount and cost of the subsidy, together with the identity of the recipients and of the payors, be calculated and placed in the public record" so that important issues of public policy may be brought into the open.

The CRA, as Professors Macey and Miller point out, is clearly a regulatory "tax." Moreover, to the extent the regulatory authorities have been unsuccessful in "controlling entry" into the banking industry, Professors Macey and Miller also seem correct in asserting the "tax" is discriminatory because firms like Merrill Lynch that di-

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163. Id. at 29.
164. Id. at 29, 34-35.
165. Id.
166. Id. at 43.
167. Id.
168. Id. at 41.
169. Id. at 41-43.
170. Id. at 45-47.
171. Id. at 43-44.
172. Id. at 47.
173. Macey & Miller, supra note 1, at 312-13.
rectly compete with depository institutions are not covered by the CRA and do not have to pay the "tax."\textsuperscript{174}

Our empirical data support Professor Posner's hypothesis that there are considerable incentives for banks not to comply with the CRA.\textsuperscript{175} CRA compliance may hurt not just a bank's shareholders or creditors but also potentially its customers, who may have to pay higher prices for, or perhaps be denied, certain services.\textsuperscript{176} One president of a small community bank recently questioned about the CRA noted that banks are "market driven," and if they are not meeting the needs of their communities, they will not be successful.\textsuperscript{177} He added that "the community ought to decide that, not the regulators."\textsuperscript{178}

Nevertheless, to the extent there are overriding public policy concerns in providing all segments of society with adequate access to banking services and credit, the CRA's taxation by regulation may be the most efficient way to achieve this end.\textsuperscript{179} The goal of this Article has simply been to shed some light on the workings of a statute that for so many years have been shrouded in secrecy,\textsuperscript{180} and, as Professor Posner would put it, to bring this issue more "into the open."\textsuperscript{181}

\textbf{Conclusion}

On July 1, 1990, Congress for the first time required that depository institution CRA ratings be made available to the public. Through our collection and compilation of all the CRA ratings released to the public during the first two years of this public disclosure,\textsuperscript{182} and the correlation and analysis of these ratings against a wide range of depository institution financial data, we have hopefully been able to shed some significant light on the actual operation of the CRA. Our data

\begin{itemize}
  \item \textsuperscript{174} See id.; see also Macey, supra note 16, at A10 (discussing the inefficiency of the CRA regulatory scheme); Siconolfi, supra note 107, at A1, A8 (discussing Merrill Lynch's expansion into traditional banking activities).
  \item \textsuperscript{175} See infra Tables One and Three. Concerns in this regard are at the heart of the Clinton Administration's CRA reform proposals.
  \item \textsuperscript{176} See Posner, supra note 156, at 24.
  \item \textsuperscript{177} See Joe Toland, Reinvestment Act Not Necessary for Local Banks, BRAZOS VALLEY BUS. J., July 1993, at 7 (interview with Allan Hanson, President, Commerce National Bank, College Station, Texas).
  \item \textsuperscript{178} Id.
  \item \textsuperscript{179} See generally Posner, supra note 156, at 45-47 (stating the advantages of taxation by regulation).
  \item \textsuperscript{180} Until 1990, bank and thrift CRA ratings were not released to the public, and even today the precise evaluative standards being used are unclear. See supra notes 18, 27-30, 74-80 and accompanying text.
  \item \textsuperscript{181} Posner, supra note 156, at 47.
  \item \textsuperscript{182} We gathered over 4,200 ratings from July 1, 1990 to March 31, 1992.
\end{itemize}
reveal significant potential problems with the CRA—the assignment of ratings is too subjective, financial institutions have incentive to avoid compliance, and the failure to apply the CRA to nondepository financial institutions has created unfair competition for banks that do comply. Federal banking regulators, in their proposed new CRA regulations of December 21, 1993, have responded to some of these problems, particularly in the subjectivity of enforcement. The proposed new regulations do not, however, address the “unlevel playing field” created by not applying the CRA to mutual funds and other financial intermediaries. Indeed, the more objective standards and stricter enforcement called for in the new regulations may further exacerbate this problem. In addition, despite the concerns of the regulators that the proposed new objective CRA standards not be “formulaic,” it seems difficult to see how they will be otherwise. The result of all this is that depository institutions are going to be under increasing pressure to make loans and provide services of a kind they would not, using normal business judgment, make or provide. Such CRA “taxation by regulation” does indeed appear to put the federal government firmly in the credit allocation business.
<table>
<thead>
<tr>
<th>VARIABLE</th>
<th>(1) CRA Rating of 1 or 2</th>
<th>(2) CRA Rating of 3 or 4</th>
<th>DIFFERENCE (1) - (2)</th>
</tr>
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<tr>
<td>LOANS</td>
<td>52.97%</td>
<td>51.47%</td>
<td>1.50</td>
</tr>
<tr>
<td>SINGLE-FAMILY RESIDENCE LOANS</td>
<td>13.63%</td>
<td>12.84%</td>
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<td>10.30%</td>
<td>10.32%</td>
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<td>MULTIFAMILY LOANS</td>
<td>0.48%</td>
<td>0.72%</td>
<td>-0.24</td>
</tr>
<tr>
<td>MARKETABLE SECURITIES</td>
<td>29.74%</td>
<td>28.74%</td>
<td>1.00</td>
</tr>
<tr>
<td>NET INTEREST INCOME</td>
<td>3.93%</td>
<td>4.10%</td>
<td>-0.17*</td>
</tr>
<tr>
<td>PROVISION FOR LOAN LOSSES</td>
<td>0.40%</td>
<td>0.65%</td>
<td>-0.25**</td>
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<tr>
<td>TOTAL ASSETS (thousands)</td>
<td>$676,560</td>
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<td>3.80%</td>
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<td>NUMBER OF AFFILIATES</td>
<td>1.89</td>
<td>1.04</td>
<td>0.85</td>
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* indicates statistical significance at the 5% level
** indicates statistical significance at the 1% level
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<th>(2) CRA RATING OF 4</th>
<th>DIFFERENCE</th>
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<tr>
<td>LOANS</td>
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<td>52.97%</td>
<td>3.35</td>
</tr>
<tr>
<td>SINGLE-FAMILY RESIDENCE LOANS</td>
<td>14.25%</td>
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<td>4.12**</td>
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<td>CONSUMER LOANS</td>
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</tr>
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<td>MULTIFAMILY LOANS</td>
<td>0.59%</td>
<td>0.26%</td>
<td>-0.33**</td>
</tr>
<tr>
<td>MARKetable SECURITIES</td>
<td>22.59%</td>
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<td>NET INTEREST INCOME</td>
<td>3.91%</td>
<td>4.57%</td>
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<tr>
<td>PROVISION FOR LOAN LOSSES</td>
<td>0.33%</td>
<td>0.72%</td>
<td>-0.39</td>
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<td>TOTAL ASSETS (thousands)</td>
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<td>$123,047**</td>
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<td>HOLDING COMPANY</td>
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<td>NUMBER OF AFFILIATES</td>
<td>1.39</td>
<td>1.00</td>
<td>0.39</td>
</tr>
</tbody>
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* indicates statistical significance at the 5% level  
** indicates statistical significance at the 1% level
TABLE THREE

Logistic Regression Results for Regression of CRA Rankings on Total Assets, Loan Ratio, Loan Mix Ratios, Marketable/Investment Securities Ratio, Bank Performance Ratios, Trading Status, Multibank Holding Company Status, and Number of Affiliates. The Dependent Variable takes a value of 1 if the CRA Rating is 1 or 2 and a value of 0 if the CRA Rating is 3 or 4.

<table>
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<tr>
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<th>MODEL 2</th>
<th>MODEL 3</th>
<th>MODEL 4</th>
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<td>INTERCEPT</td>
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<td>0.0284</td>
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<td>2.6969**</td>
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<td>0.2261</td>
<td>0.8047</td>
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<td></td>
<td></td>
<td>2.4597**</td>
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<tr>
<td>NET INTEREST INCOME</td>
<td>-11.2462**</td>
<td>-11.2441**</td>
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<tr>
<td>PROVISION FOR LOAN LOSSES</td>
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<tr>
<td>TOTAL ASSETS</td>
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<td>8.59E.8</td>
<td>1.01E.7</td>
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<tr>
<td>TRADED</td>
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<td></td>
<td>0.6777**</td>
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<tr>
<td>NUMBER OF AFFILIATES</td>
<td>0.5588**</td>
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</tr>
</tbody>
</table>

* indicates statistical significance at the 5% level
** indicates statistical significance at the 1% level
### LOGISTIC REGRESSION RESULTS FOR REGRESSION OF CRA RANKINGS ON TOTAL ASSETS, LOAN RATIO, LOAN MIX RATIOS, MARKETABLE/INVESTMENT SECURITIES RATIO, BANK PERFORMANCE RATIOS, TRADING STATUS, MULTIBANK HOLDING COMPANY STATUS, AND NUMBER OF AFFILIATES. THE DEPENDENT VARIABLE TAKES A VALUE OF 1 IF THE CRA RATING IS 1 AND A VALUE OF 0 IF THE CRA RATING IS 4.

<table>
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<tr>
<th>INDEPENDENT VARIABLES</th>
<th>MODEL 1</th>
<th>MODEL 2</th>
<th>MODEL 3</th>
<th>MODEL 4</th>
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<td>INTERCEPT</td>
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<td>3.89</td>
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<td>-50.96**</td>
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<td>PROVISION FOR LOAN LOSSES</td>
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</tr>
</tbody>
</table>

* indicates statistical significance at the 5% level
** indicates statistical significance at the 1% level
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