

Boston University Journal of Science & Technology Law

Note

Encouraging Community Development in Cyberspace:
Applying the Community Reinvestment Act to Internet Banks

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Encouraging Community Development in Cyberspace: Applying the Community Reinvestment Act to Internet Banks[†]

Miho Kubota*

I. INTRODUCTION

1. In 1977, Congress enacted the Community Reinvestment Act¹ (“CRA”) to encourage banks to serve the credit needs of their entire communities, including low- and moderate-income individuals and areas.² This legislation has been the subject of much controversy, as bankers, regulators, and community groups attempt to understand banks’ responsibilities to reinvest in their communities.³ Recently, Congress amended the CRA in response to concerns that CRA enforcement focused too much on process and not enough on results.⁴ However, certain compliance issues still require attention, including how to apply the statute to Internet banks that are geographically boundless, when Congress based the statute on the premise that banks have an affirmative duty to reinvest in their geographic communities.

2. There are few banks which operate solely on the Internet.⁵ Security First Network Bank (“SFNB”) started doing business on the Internet in 1995.⁶ As a bank

[†] © 1999 by the Trustees of Boston University. Cite to this Note as 5 B.U. J. SCI. & TECH. L. 8 (1999). Pin cite using the appropriate paragraph number. For example, cite the first paragraph of this Note as 5 B.U. J. SCI. & TECH. L. 8 para. 1 (1999).

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¹ 12 U.S.C. §§ 2901–2907 (1994).

² See 12 U.S.C. § 2903(a)(1). “[The CRA] aims in a far too much neglected area, which is that of revitalizing, preserving, and rehabilitating our existing neighborhoods. . . . [It] is not uniquely a big city problem. It can strike just as hard in rural areas, or in small- or medium-sized cities.” *Community Credit Needs: Hearings on S. 406 Before Comm. on Banking, Hous., and Urban Affairs*, 95th Cong. 159 (1977) (statement of Sen. Heinz).

³ See generally GENERAL ACCOUNTING OFFICE, COMMUNITY REINVESTMENT ACT: CHALLENGES REMAIN TO SUCCESSFULLY IMPLEMENT CRA (1995) [hereinafter GAO REPORT] (discussing the CRA’s problems, as identified by regulators, the public, and bankers).

⁴ The last of the new regulations came into effect in July of 1997. See 12 C.F.R. § 25.51 (1997). The new regulations seek to “emphasize performance rather than process, to promote consistency in evaluations, and to eliminate unnecessary burden.” Community Reinvestment Act Regulations, 60 Fed. Reg. 22,156, 22,156 (1995).

⁵ See Jennifer Kingson Bloom, *Puzzler: What’s CRA Duty of an On-Line Bank*, AM. BANKER, Jan. 7,

operating almost entirely on the Internet (it has one brick and mortar office in Atlanta), it was the first of its kind.⁷ Computer and communications insiders expect an increase in the number of Internet banks,⁸ raising the issue of how these new types of banks should identify and reinvest in their communities.

3. This Note argues that Internet banks should contribute to community reinvestment in a manner commensurate to that of traditional banks. It finds that the current CRA and its regulations do not account for the unique characteristics and service potentials of Internet banks. This Note concludes that Congress should broaden the CRA's reach to include all lending institutions and implement a subsidy-based approach to encourage affirmative community development activities by these institutions.⁹

4. Part II of this Note provides a brief history of the CRA. Part A describes the CRA's purpose and the rationales for requiring banks to reinvest in their communities. It also discusses how one of the major premises behind the CRA, that banks are local and should serve local needs, is no longer effective because of the financial industry's rapidly changing character. Part B discusses various amendments to the CRA and the criticisms which community groups, bankers, and regulators levy against the Act. It also discusses how recent regulatory changes incorporated different assessment standards for different types of depository and savings institutions. Part B concludes by discussing the CRA's dependence on geographic boundaries and the difficulty this creates when applying the CRA to Internet banks.

5. Part III describes how Internet banks operate and the factors that will contribute to an increase in the number of Internet banks. It will also show that Internet bank operations are misaligned with the current CRA's premise and regulations, because the banks are not part of a defined community. It compares Internet banks to non-bank lenders who are not subject to the CRA, because both enjoy a competitive advantage over traditional banks which, in contrast, must comply with the CRA.

1997, at 18 (finding that, thus far, just a "handful of banks . . . transact exclusively through remote channels").

⁶ See Penny Lunt, *Welcome to sfnb.com: The Paradigm Just Shifted*, ABA BANKING J., Dec. 1995, at 40, 40.

⁷ See Bloom, *supra* note 5, at 18.

⁸ See *infra* Part III.B.

⁹ The discussion in this Note will be limited to CRA compliance issues for banks conducting all or most of their business on the Internet. This Note will not address how traditional banks that conduct a small but significant portion of their business on the Internet should comply with the CRA. Although this latter topic *is* significant, the factors involved in the analysis are sufficiently different to warrant separate consideration.

6. Part IV of this Note addresses past criticisms of the CRA and the realities of Internet access and banking. It argues that Congress must develop a new CRA that applies to Internet banks. It discusses options that regulators should consider when deciding how Internet banks should reinvest in their “communities” and suggests that the new CRA should define an Internet bank’s community as national in scope. Internet banks should serve as test cases for implementing a subsidy system that encourages affirmative CRA compliance from banks and other financial institutions.

II. HISTORY OF THE COMMUNITY REINVESTMENT ACT (“CRA”)

A. The CRA’s Purpose

7. Congress enacted the CRA in 1977 in response to charges that banks were systematically denying credit to lower- and moderate-income individuals and minorities through a process called “redlining.”¹⁰ Through the CRA, Congress encouraged banks to provide credit services to individuals in the banks’ surrounding communities, including low- and moderate-income individuals.¹¹ The statute specifically stated that banks have affirmative obligations to meet the credit needs of the communities that charter them.¹² Although banks are private entities, the CRA’s rationale is that banks have obligations to the public because they benefit from federal government protections, such as federal deposit insurance and the Federal Reserve System’s lending of last resort.¹³ Furthermore, Congress premised the banks’ obligations on the proposition that banking was a local industry, and, as such, banks should reinvest in their local communities.¹⁴ While the *quid pro quo* rationale¹⁵ has not changed over time, the argument that banks are local and should serve local needs has eroded as state laws have allowed extensive branch banking, and as technologies such as electronic funds transfer and data processing

¹⁰ 123 CONG. REC. 17,630 (1977) (statement of Sen. Proxmire) (referring to the practice of “actually or figuratively” drawing a red line on a map around neighborhoods it declined to invest in, particularly inner city and minority areas).

¹¹ See 12 U.S.C. § 2903(a)(1) (1994); see also 123 CONG. REC. 17,630.

¹² See 12 U.S.C. § 2901.

¹³ See Allen J. Fishbein, *The Community Reinvestment Act After Fifteen Years: It Works, But Strengthened Federal Enforcement is Needed*, 20 FORDHAM URB. L.J. 293, 293 (1993) (“These public obligations form the quid pro quo for [such] extensive government backing.”).

¹⁴ See 123 CONG. REC. 17,630 (“We need to encourage bankers to get out of the office and walk around the block and find loan opportunities here at home. The law already provides that banks are chartered to meet the convenience and needs of their communities.”).

¹⁵ See Fishbein, *supra* note 13, at 293.

have allowed banks to conduct business over increasingly dispersed areas.¹⁶ The evolution of Internet banking is one manifestation of the changing financial services industry. Congress must respond to these changes by modifying the CRA to include methods by which Internet banks can fulfill their affirmative obligations to their communities, in the same manner as traditional banks.

B. Amendments and Criticisms of the CRA

8. Legal scholars, community advocates, and bank officials have extensively criticized the CRA for failing to accomplish its goals while levying unnecessarily large regulatory burdens on banks.¹⁷ The original CRA required lending institutions to delineate their communities for CRA purposes,¹⁸ prepare a "CRA Statement,"¹⁹ maintain a "Public File,"²⁰ and provide the public with notice of its rights under the CRA.²¹ The regulatory agencies assessed each institution's

¹⁶ See Jonathan R. Macey & Geoffrey P. Miller, *The Community Reinvestment Act: An Economic Analysis*, 79 VA. L. REV. 291, 305-306 (1993).

¹⁷ See, e.g., Claudia Cummins, *U.S.: Vary CRA Rules for Big, Small Banks*, AM. BANKER, Dec. 9, 1993, at 1 (stating that bankers complained that the CRA was their largest regulatory burden); Fishbein, *supra* note 13, at 296 (discussing the statement by the General Counsel of the Center for Community Change that "community advocates have criticized the way in which the regulators enforced the CRA"); Macey & Miller, *supra* note 16, at 294 (discussing conclusions by law professors at Cornell University and the University of Chicago that the "CRA . . . does more harm than good").

¹⁸ See WARREN L. DENNIS & J. STANLEY POTTINGER, FEDERAL REGULATION OF BANKING: REDLINING AND COMMUNITY REINVESTMENT: ANALYSIS, COMMENTARY AND COMPLIANCE PROCEDURES ¶ 9.06[2], at 9-24 (1980). The original CRA required each bank to review its delineation annually, and regulators then reviewed the bank's delineation for its "reasonableness." See *id.*

¹⁹ *Id.* ¶ 9.06[2], at 9-24 to 9-25. The CRA Statement included notice of available credit and a copy of the CRA notice. See *id.* at 9-25. Banks could also include a report on their CRA lending and marketing activities. See *id.*

²⁰ *Id.* ¶ 9.06[2], at 9-25. Banks had to include written public comments on their CRA performance and CRA Statements for the past two years within their public files. See *id.* Each bank had to make this file available at its main office. See *id.*

²¹ See *id.* ¶ 9.06[2], at 9-25. The CRA required banks to notify the public that they were entitled to:

[g]et a copy of the lender's CRA statement; [f]ile comments with the lender and/or with the [overseeing] agency; [s]ee copies of other comments on file with the lender; [s]ee copies of other comments made to the agency; and [r]equest placement of their name on the agency mailing list in order to obtain notice of all applications made by the lender which are covered by CRA.

Id.

performance by evaluating it against twelve unweighted criteria²² both at regularly scheduled examinations and when banks applied to make “structural change[s]” in their operations.²³ When assessing an institution’s performance, regulators assigned banks a numerical rating of one to five.²⁴ Although the regulations themselves did not require banks to maintain detailed records of their lending activities, banks often kept extensive records to document their efforts under the twelve criteria.²⁵

9. Since its enactment in 1977, Congress has amended the CRA four times in an effort to increase its effectiveness.²⁶ In the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (“FIRREA”), Congress required banks to disclose evaluations of their CRA compliance to the public and changed the numerical rating system to four descriptive categories: “outstanding,” “satisfactory,” “needs to improve,” and “substantial noncompliance.”²⁷ Congress strengthened the disclosure requirements again in 1991 by requiring that the public CRA evaluation include a discussion of the data used in assessing the banks’ performances.²⁸ The Housing and Community Development Act of 1992 encouraged bank cooperation with minority- and women-owned financial institutions and low-income credit unions by making such cooperation a factor in assessing a bank’s level of

²² See *id.* ¶ 9.10[1][b], [2]-[10], at 9-62 to 9-74. The criteria were: (1) the lender’s activities aimed at understanding the credit needs of its community; (2) the amount of marketing which the bank used to notify the community of its available credit services; (3) the amount of participation by the bank’s Board of Directors in developing and evaluating the bank’s CRA compliance; (4) “any practices intended to discourage applications for types of credit set forth in the bank’s CRA statement(s);” (5) the geographic distributions of the bank’s credit applications, extensions, and denials; (6) any “evidence of prohibited discriminatory or other illegal credit practices;” (7) the bank’s record of opening and closing branches (in low- to moderate-income neighborhoods in particular); (8) the bank’s participation and investment in community development programs; (9) the number of the bank’s loans that originated in its community; (10) the institution’s participation in government-related housing, small business, and small farm loan programs; (11) the institution’s ability to meet the needs of its community (based on such factors as the institution’s size, financial state, local economic conditions, etc.); and (12) any other factors relevant to the regulatory agency’s determination of how the bank has complied with the CRA. *Id.*

²³ *Id.* ¶ 9.01[2][c], at 9-5.

²⁴ See *id.* at 9-7.

²⁵ See *id.* ¶ 9.06[1], at 9-24.

²⁶ See GAO REPORT, *supra* note 3, at 17.

²⁷ 12 U.S.C. § 2906(a)(2), (b)(2) (1994); see also GAO REPORT, *supra* note 3, at 17.

²⁸ See 12 U.S.C. § 2906(b)(1)(A)(ii); see also GAO REPORT, *supra* note 3, at 17.

compliance.²⁹ Lastly, the “community” orientation of the CRA was reinforced in 1994 by a provision in the Riegle-Neal Interstate Banking and Branching Efficiency Act, which required institutions that operate in more than one state to receive separate CRA ratings and evaluations for each state in which they operate.³⁰ These amendments furthered the CRA’s purpose by increasing the importance of community involvement in a bank’s CRA performance review, promoting local businesses, and rewarding banks for forming business relationships with minority- and women-owned businesses.

10. In 1992, Bill Clinton made CRA enforcement a presidential campaign issue.³¹ In July 1993, as President, he delivered on his promise and ordered new regulations that more effectively evaluated a bank’s performance in providing credit services to its community.³² Clinton’s call for reform led the General Accounting Office (“GAO”) to prepare a detailed study of the criticisms surrounding the existing regulations, the effectiveness of the new regulatory reforms, and the most effective means of implementing the new regulations.³³ In its report, the GAO summarized the criticisms of the existing CRA:

- too little reliance on lending results and too much reliance on documentation of efforts and processes, leading to an excessive paperwork burden;
- inconsistent CRA examinations by regulators resulting in uncertainty about how CRA performance is to be rated;
- examinations based on inadequate information that may not reflect a complete and accurate measure of institutions’ performance; and
- dissatisfaction with regulatory enforcement of the act, which largely relies on protests of expansion plans to ensure institutions are responsive to community credit needs.³⁴

²⁹ See 12 U.S.C. § 2903; see also GAO REPORT, *supra* note 3, at 17.

³⁰ See 12 U.S.C. § 2906(d)(1)-(2); see also GAO REPORT, *supra* note 3, at 17.

³¹ See Brooke Overby, *The Community Reinvestment Act Reconsidered*, 143 U. PA. L. REV. 1431, 1432 n.10 (1995).

³² See *id.* at 1432-33.

³³ See GAO REPORT, *supra* note 3, at 41.

³⁴ *Id.* at 44.

11. The GAO found that bankers, regulators, and community groups agreed on the CRA's major problems but disagreed on how to address them.³⁵ Bankers thought that CRA examinations should focus less on the banks' procedures for meeting CRA obligations and more on the banks' actual performances.³⁶ They also advocated for advanced approval of CRA strategic plans and sought guarantees, or "safe harbors," to allow banks that earned satisfactory or outstanding ratings to move or expand operations without CRA protests.³⁷ Regulators agreed that they should evaluate each bank according to its performance and de-emphasize each bank's documentation of its compliance efforts.³⁸ On the other hand, community groups wanted access each bank's data on actual lending and the services provided to the communities.³⁹ They also argued that they should participate in the evaluation process.⁴⁰ In response to these concerns, regulators designed the new regulations to significantly reduce the time that banks needed to spend on data production.⁴¹ Whether these new regulations will solve the problems of examination inconsistency, inadequate information, and regulators' overdependence on community group enforcement has yet to be seen.⁴² Any attempt to apply the CRA to Internet banks must address these problems as well.

³⁵ *See id.* at 44-45. The GAO based its findings on: (1) interviews with regulators, bankers, and community groups; (2) case studies of CRA compliance examinations at banks and thrifts in the Northeast, Midwest, West, and South Central United States; (3) letters submitted in response to the proposed CRA regulations; and (4) transcripts from hearings on revising the CRA regulations. *See id.* at 41-43.

³⁶ *See id.* at 45 (reporting on complaints that the CRA's focus on bank processes required the banks to produce extensive documentation for CRA examinations).

³⁷ *See id.* Regulators included the strategic plan option in the new regulations. *See* 12 C.F.R. § 25.21(a)(4) (1998).

³⁸ *See* GAO REPORT, *supra* note 3, at 46.

³⁹ *See id.* at 45-46 (discussing concerns that the CRA examination failed to assess a bank's actual contributions to its community through loans and services).

⁴⁰ *See id.* at 46.

⁴¹ *See id.* at 50 (reporting that the new regulations require regulators to evaluate the results, not the processes, of each bank's community reinvestment efforts).

⁴² *See id.* The new regulations may not reduce the problem of examination inconsistency because they, like the earlier regulations, require regulators to assess the bank's performance along subjective standards. *See id.* at 51. Banks, community groups, and regulators continue to disagree about the type and amount of information banks should disclose and whether community groups should have access to that data. *See id.* at 47. Lastly, bankers and community groups find that regulatory enforcement of the CRA is problematic. *See id.* at 48. Bankers complain that a "satisfactory" or "outstanding" CRA rating does not shield them from community group protests when they apply to expand. *See id.* On the other hand, community groups thought that the regulations did not create adequate incentives for bank compliance, because prohibition of expansion

1. New Regulations: Assessment Standards

12. The new regulations recognize differences among the types of depository and savings institutions by subjecting banks to different tests and standards.⁴³ The Office of the Comptroller of the Currency (“OCC”) applies the lending, investment, and services tests to most banks.⁴⁴ Under the lending test, regulators evaluate a bank’s commercial and consumer loans according to several criteria, including the geographic coverage of consumer loans, the number and amount of commercial loans, borrowers’ income characteristics, and the bank’s community development lending record.⁴⁵ The investment test evaluates a bank’s record of investments in the bank’s community, excluding those investments considered under the lending and service tests.⁴⁶ The service test considers the availability and effectiveness of a bank’s retail banking services, including the number and distribution of branches in low- and moderate-income areas, and the extent to which the bank provides community development services.⁴⁷

13. Regulators acknowledged structural distinctions between traditional banks, wholesale or limited purpose banks, and small banks by establishing separate standards for the institutions in the latter two categories. The CRA defines wholesale banks as those that do not offer “home mortgage, small business, small farm, or consumer loans to retail customers.”⁴⁸ Limited purpose banks are those that do not offer the traditional service offerings of banks, but offer a limited product line “(such as credit card or motor vehicle loans) to a regional or broader market.”⁴⁹ The CRA assesses these by the less specific and more flexible standards

and adverse publicity from protests were the only potential sanctions available against banks. *See id.* at 49.

⁴³ *See* 12 C.F.R. § 25.21(a)(2)-(3) (1998) (describing separate tests for wholesale or limited purpose banks and small banks).

⁴⁴ *See id.* § 25.21(a)(1). The OCC is one of four regulatory agencies that enforce the CRA. *See* GAO REPORT, *supra* note 3, at 20-21. The other three enforcement agencies are the Federal Reserve Board (“FRB”), the Federal Deposit Insurance Corporation (“FDIC”), and the Office of Thrift Supervision (“OTS”). *See id.* These regulatory agencies all participated in developing CRA regulations, which are codified at different sections in the C.F.R. *See* 12 C.F.R. § 228.11(a) (1998) (FRB regulations); 12 C.F.R. § 345.11(b) (1998) (FDIC regulations); 12 C.F.R. § 563.1(a) (1998) (OTS regulations). For the sake of simplicity, this Note refers to all of the CRA regulatory agencies when it references the OCC.

⁴⁵ *See* 12 C.F.R. § 25.22(a)-(b).

⁴⁶ *See id.* § 25.23(a)-(b).

⁴⁷ *See id.* § 25.24(a), (d)(1), (e)(1).

⁴⁸ *Id.* § 25.12(w).

⁴⁹ *Id.* § 25.12(o).

of the community development test.⁵⁰ The community development test evaluates the number, size, innovativeness, and responsiveness of a bank's community development loans, services, and investments.⁵¹

14. Similarly, the CRA assesses small banks⁵² according to a different set of standards.⁵³ Regulators recognized that the data collection efforts necessary to comply with the standard CRA tests imposed a disproportionate burden on institutions with small staffs and little resources.⁵⁴ In its evaluation, the OCC considers, among other criteria, a small bank's loan to deposit ratio, the percentage of loans that are located in the bank's community, the bank's record of lending to borrowers of different income levels, and the geographic distribution of the loans.⁵⁵

15. Furthermore, regulators developed a "strategic plan"⁵⁶ option to allow all banks additional flexibility in complying with the CRA.⁵⁷ The option allows banks to allocate CRA compliance activities among affiliates in the same assessment areas.⁵⁸ Banks pursue this option by submitting a strategic plan to the OCC for preapproval.⁵⁹ A bank prepares its strategic plan to meet the credit needs of its community, seeks public input about the plan, then submits the plan at least three months prior to the proposed start date.⁶⁰ The plan must contain "measurable goals" to meet the credit needs of the community; address how the bank would fulfill the lending, service, and investment tests; and identify a standard for "satisfactory" performance under the plan.⁶¹ The bank may also specify a standard

⁵⁰ *See id.* § 25.21(a)(2).

⁵¹ *See id.* § 25.25(a), (c).

⁵² *See id.* § 25.12(t) (defining small banks as those having total assets of less than \$250 million).

⁵³ *See id.* § 25.21(a)(3).

⁵⁴ *See* Community Reinvestment Act Regulations, 60 Fed. Reg. 22,156, 22,168 (1995) (describing the reasons for establishing separate standards for smaller banks).

⁵⁵ *See* 12 C.F.R. § 25.26(a).

⁵⁶ *See id.* § 25.27.

⁵⁷ *See* Community Reinvestment Act Regulations, 60 Fed. Reg. at 22,168 (describing the rationale for adding a strategic plan option).

⁵⁸ *See* 12 C.F.R. § 25.27(c)(3).

⁵⁹ *See id.* § 25.21(a)(4).

⁶⁰ *See id.* § 25.27(a), (d)-(e).

⁶¹ *Id.* § 25.27(f)(1), (3).

for “outstanding” performance.⁶² In evaluating the strategic plan, the OCC considers the bank’s loan distribution, the innovativeness of the bank’s investments, and the bank’s ability to provide “retail banking services.”⁶³ Regardless of the applicable test, however, the OCC will measure a bank’s performance against standards developed according to the demographic characteristics of the bank’s geographic area.⁶⁴

2. Dependence on Geographic Boundaries

16. The OCC’s evaluation of a bank’s CRA performance is entirely dependent on proper identification of the community, or assessment area,⁶⁵ that the bank serves.⁶⁶ The OCC measures each bank’s community reinvestment activities against the needs of its assessment areas.⁶⁷ Banks identify *who* they serve by delineating their own assessment areas for CRA evaluations, although their decisions are subject to OCC review.⁶⁸ Under the CRA regulations, a bank’s assessment area includes the geographic areas where the bank has its main office, branches, “deposit-taking ATMs,”⁶⁹ and areas in which the bank originated loans.⁷⁰ Regulators use the median income level within the bank’s assessment area as the basis for identifying low-, moderate-, middle-, and upper-income areas and individuals.⁷¹ In addition to this information, the OCC reviews housing costs and the types of housing available in a bank’s assessment area to determine the area’s

⁶² *Id.* § 25.27(f)(3).

⁶³ *Id.* § 25.27(g)(3).

⁶⁴ *See id.* §§ 25.21(b)(1), 25.41 (identifying the factors the OCC considers in measuring a bank’s CRA performance and determining a bank’s assessment areas).

⁶⁵ *See id.* § 25.12(c) (defining “assessment area” as “a geographic area delineated in accordance with § 25.41”); *see id.* § 25.41.

⁶⁶ *See id.* § 25.41(a).

⁶⁷ *See id.*; *see id.* §§ 25.22(a), 25.23(a), 24.24(a).

⁶⁸ *See id.* § 25.41(a).

⁶⁹ *Id.* § 25.41(b)-(c).

⁷⁰ *See id.* § 25.41(c)(2). Wholesale and limited purpose bank assessment areas do not include areas in which loans have originated. *See id.* § 25.41(c).

⁷¹ *See id.* § 25.12(n). The OCC identifies low-, moderate-, middle-, and upper-incomes by comparing individual income levels against the area median income. *See id.* For example, income less than fifty percent of the area median income is low-income. *See id.* § 25.12(n)(1).

needs.⁷² Regulators will also analyze a bank's loan, investment, and service information within the bank's geographic assessment area to evaluate how well a bank meets the area's needs.⁷³ Therefore, the bank's definition of its assessment area forms the basis for the regulators' final determination of *who* the banks and savings and loan associations should serve under the CRA and *how* they should serve these communities.

17. How broadly or narrowly a bank defines its assessment area is critical to the outcome of its CRA evaluation.⁷⁴ If a bank defines its area too narrowly, regulators and community groups will complain that the bank may be avoiding larger credit needs in the surrounding areas.⁷⁵ On the other hand, defining an assessment area too broadly may leave a small bank with more credit responsibilities than it can handle, because regulators will assess its performance against lending activities and opportunities in the larger area.⁷⁶ Thus, the regulations heavily depend on accurate identification of bank assessment areas to evaluate compliance with the CRA.

18. The regulations' dependence on and heavy use of geographic areas creates a significant problem in applying the existing regulations to Internet banks. A bank such as Security First Network Bank ("SFNB") is chartered as a bank and offers services similar to those which traditional banks offer.⁷⁷ Thus, it is a "regulated financial institution" subject to the CRA.⁷⁸ Unlike traditional banks and savings institutions, however, an Internet bank's geographic presence neither defines nor limits its activities.⁷⁹ Therefore, to effectively apply the CRA to the

⁷² See *id.* § 25.21(b)(1).

⁷³ See *id.* § 25.21(b)(2).

⁷⁴ See Jonathan P. Tomes, *The "Community" in the Community Reinvestment Act: A Term in Search of a Definition*, 10 ANN. REV. BANKING L. 225, 240 (1991).

⁷⁵ See *id.* (discussing community group protests of a proposed merger between Mitsui Bank and Taiyo Kobe Bank, because Mitsui "define[d] their community as a small radius around their branches, instead of all of Los Angeles County") (citing Blackman, *Bank Merger May Be Affected by Lending Protests*, L.A. BUS. J., Mar. 5, 1990, at 3).

⁷⁶ See *id.* Tomes, *supra* note 74, at 248 (citing *Community Reinvestment Act*, 7A BANKING L. (MB) § 158.04(1), at 158-12).

⁷⁷ See Bloom, *supra* note 5, at 18; see also Security First Network Bank, *Products and Services* (last modified Mar. 30, 1999) <<http://www.sfnb.com/infodesk/infodesk.html>> (stating that the bank offers basic checking and savings accounts, credit cards, money markets, and interest checking, among other things).

⁷⁸ 12 U.S.C. § 2902(2) (1994) (defining a "regulated financial institution" as an insured depository institution).

⁷⁹ See *infra* notes 108-11 and accompanying text.

growing number of Internet banks, regulators must reevaluate the CRA's focus on geography.

III. BANKS BASED SOLELY ON THE INTERNET

A. Internet Bank Operations

19. In October 1995, SFNB introduced its Web site and began to offer non-interest bearing checking accounts.⁸⁰ Five Paces Software,⁸¹ a spin-off of the Atlanta company, SecureWare, designed SFNB's secure operating system.⁸² The Office of Thrift Supervision ("OTS") awarded SFNB a thrift charter after completing extensive tests of its systems,⁸³ and SFNB's deposits have FDIC insurance coverage.⁸⁴ The bank is open to any customer who has access its web site, and both technical service and customer support representatives are available twenty-four hours a day to answer customers' queries by phone and e-mail.⁸⁵

20. Customers open accounts at SFNB by filling out an application on the Web site, printing it out to sign it, and then mailing it to the bank's brick and mortar branch⁸⁶ in Atlanta, Georgia,⁸⁷ where employees can demonstrate the bank's online services.⁸⁸ The bank's customers benefit from home banking conveniences, such as viewing statements and account registers on-line and ordering twenty free

⁸⁰ See Lunt, *supra* note 6, at 40-41.

⁸¹ Five Paces Software has since changed its name to Security First Technologies. See Bill Orr, *SFNB Marks One Year on the Frontline of Internet Banking*, ABA BANKING J., Dec. 1996, at 62, 62 [hereinafter Orr, *SFNB Marks One Year*].

⁸² See Bill Orr, *Security: What Everyone's Wondering About*, ABA BANKING J., Dec. 1995, at 45, 45 [hereinafter Orr, *Security*]. SecureWare was the "leading provider of 'trusted' operating systems" for the Pentagon and worked with Hewlett-Packard to modify its Department of Defense operating system for Internet banking use. See *id.*

⁸³ See Lunt, *supra* note 6, at 40. The OTS tested SFNB's security system by having student hackers attempt a break-in, to no avail. See *id.*

⁸⁴ See Orr, *Security*, *supra* note 82, at 62.

⁸⁵ See Lunt, *supra* note 6, at 41.

⁸⁶ "Brick and mortar" refers to a physical structure (as compared to a virtual location, such as a Web site). See, e.g., Bloom, *supra* note 5, at 18.

⁸⁷ See Security First Network Bank, *Account Application* (last modified Feb. 3, 1999) <<http://www.sfnb.com/apply/cusapp.html>>.

⁸⁸ See Security First Network Bank, *Who We Are* (last modified Dec. 20, 1998) <http://www.sfnb.com/atlanta/who_we_are_co_staff.html>.

electronic payments a month. The customers also enjoy a no-risk guarantee against computer fraud losses, in addition to FDIC insurance.⁸⁹

B. Estimated Growth of Internet Banks

21. Since the introduction of SFNB, the number of Internet banks has continued to grow.⁹⁰ Three factors will drive the continued growth of Internet banks: customer demand for on-line banking, the cost efficiencies of on-line banking, and the quality of security of on-line banking.⁹¹

1. As Internet Use Increases so will the Demand for On-line Banking

22. Both large and small banks are finding that a considerable percentage of their customers have computers and Internet access.⁹² Between the spring and end of 1997, the number of World Wide Web users grew 26% to approximately 48 million users.⁹³ During the same period, the number of people who bought goods or

⁸⁹ See Security First Network Bank, *Products and Services* (last modified Mar. 30, 1999) <<http://www.sfnb.com/infodesk/infodesk.html>>; Security First Network Bank, *Guarantee* (last modified Dec. 20 1998) <<http://www.sfnb.com/guarantee/>>. SFNB offers to reimburse customers for money lost from their accounts as a result of system errors and unauthorized access by criminals. See *id.*

⁹⁰ At Banking.com, customers can access several Internet banks. See *Banking.com* (visited Oct. 30, 1998) <<http://www.banking.com/sitemap.asp>>. Users can access several banks at this site, including Bank of Versailles, Citizens Bank USA, First National Bank and Trust, First National Bank of Internet, Home Federal Savings Bank, and nBank. See *id.*

⁹¹ See Joanna Sullivan, *Small Banks Find, to Their Shock, Clients Wired, Ready to Go On-Line*, AM. BANKER, Oct. 21, 1997, at 1, 1 (discussing customers' demands for on-line service and banks' desire to compete with larger banks without expanding or merging); Robert Kramer, *Shifting Bank Relationships to the Fast Lane on the Infobahn*, AM. BANKER, Nov. 17, 1997, at 8A, 8A (discussing the cost-effectiveness of Internet banking); Denise Duclaux, *The Call of the Web*, ABA BANKING J., Apr. 1996, at 20, 20 (discussing Internet banking security).

⁹² See Sullivan, *supra* note 91, at 1 (reporting that after one bank discovered that 47% of its customers owned personal computers, the bank created its own web page and expects to expand it to offer home banking services). Currently, 14% of banks holding more than \$4 billion in assets offer Internet banking services, as opposed to 1% of smaller banks with less than \$1 billion in assets. See *id.* However, 78% of the larger banks and 42% of the smaller banks that do not currently offer access plan to do so by 2000. See *id.* There is also a growth in the number of companies specializing in developing home banking technologies, perhaps "the strongest evidence that the market is for real." See Bill Orr, *Niche Players Emerge As Home Banking Gets an Infrastructure*, ABA BANKING J., June 1997, at 68, 68 [hereinafter Orr, *Niche Players Emerge*].

⁹³ See G. Christian Hill, *Adult Net Users in U.S., Canada Put at 58 Million*, WALL ST. J., Dec. 11, 1997, at A11, A11. World Wide Web users are a subset of total Internet users; some Internet users limit their online usage to electronic mail or chat groups. See *id.*

services on the Web increased by 50%.⁹⁴ About 58 million adults in North America currently use the Internet.⁹⁵

23. Besides a general increase in the number of Internet users, the number of Internet bank users is expected to increase dramatically in the near future. By the end of 1996, over 2.5 million banking customers used online banking services, and analysts expect this number to grow to 18 million by 2002.⁹⁶ New banking customers in their early twenties and entrepreneurs are fueling this growth in on-line banking.⁹⁷ Members of these groups heavily use computers and on-line services and are particularly attractive to banks because they are only just beginning to choose their financial service providers.⁹⁸ Thus, the increase in home banking customers, the youth of that group, and the overall growth in web users combine to create a growing customer base for Internet banks.

2. Internet Banking is Cost-Effective for Banks and Customers

24. Industry observers predict that the number of Internet-based banks will also grow due, in part, to their low cost structure; the banks have much lower overhead expenses compared to traditional banks.⁹⁹ Internet banks do not have to expend money on opening new branches to increase their market share, because each Internet user's personal computer essentially serves as a bank branch.¹⁰⁰ This factor highlights a major difference between Internet banks and traditional banks: an Internet bank's growth is entirely unrelated to its physical location.¹⁰¹ Furthermore, banks incur significantly lower transaction costs when customers use

⁹⁴ *See id.* (estimating that approximately 10 million people have made purchases on the web).

⁹⁵ *See id.*

⁹⁶ *See Orr, Niche Players Emerge, supra* note 92, at 68.

⁹⁷ *See Kramer, supra* note 91, at 8A (arguing that offering Internet banking services will allow banks to improve the profitability of their existing customer base and attract computer-savvy younger customers who are choosing their financial services providers).

⁹⁸ *See id.*

⁹⁹ *See Lunt, supra* note 6, at 40 (finding that SFNB can "compete effectively . . . for consumer and small business accounts all over the country, while maintaining a much lower overhead than banks that rely on bricks and mortar").

¹⁰⁰ *See William W. Streeter, "Web" Banking: Threat and Leveler, ABA BANKING J., Dec. 1995, at 17, 17; see also Sullivan, supra* note 91, at 1 (discussing how one bank found that offering Internet services was cheaper than building a new branch").

¹⁰¹ *See Duclaux, supra* note 91, at 20 (describing how some community banks "are becoming enamored with the Web as a vehicle to reach new customers located beyond the banks' geographical range").

electronic services, which cost \$0.10 to \$0.55 per ATM or Internet transaction, compared to \$1.07 to \$1.50 per branch or teller transaction.¹⁰² By encouraging customers to use electronic banking services, banks can significantly increase the profitability of their existing customers.¹⁰³ Thus, the cost-effectiveness of opening an Internet bank will prompt an increase in the number of Internet banks.

3. Increasing the Security of Internet Banking

25. Many banks were hesitant to offer Internet services because of “security fears.”¹⁰⁴ There are three types of banking web sites: (i) “interactive sites” that enable customers to go on-line to pay bills and open and close accounts; (ii) “active sites” that allow customers to view their account information and respond to questionnaires; and (iii) “static sites,” currently the most popular, that act simply as advertising for the banks and have minimal feedback capabilities.¹⁰⁵ Security concerns arise mainly with the interactive and active sites, because private financial information travels to the banks from these sites.¹⁰⁶ As security concerns ease among both banks and customers, however, banks may begin upgrading to active and interactive sites.¹⁰⁷ Therefore, as banks increasingly become less worried about security, the number of banks offering extensive banking services over the Internet will probably grow.

C. The Current CRA does not Account for Many Aspects of Internet Bank Operations

1. Internet Banks do not have a Defined Community

26. The traditional concept of community is not easily found on the Internet. Unlike other types of businesses, Internet businesses are not subject to geographic boundaries, so customers will not necessarily care about physical location when

¹⁰² See Kramer, *supra* note 91, at 8A (citing a study by Cap Gemini and Payment Systems, Inc.).

¹⁰³ See *id.* (reporting that approximately 80% of a bank’s customers are unprofitable, mostly because they use cost-intensive branch/teller transactions).

¹⁰⁴ Sullivan, *supra* note 91, at 1.

¹⁰⁵ See Duclaux, *supra* note 91, at 20.

¹⁰⁶ See *id.* (stating that interactive and active sites require banks to secure their network and “back-office banking systems” from hackers).

¹⁰⁷ See *id.* (quoting an industry insider that “the Web is evolving so quickly that it will be quite secure soon”).

choosing an Internet bank.¹⁰⁸ Internet banks are open for business to all who send their deposits to the designated location, regardless of where the customer is located.¹⁰⁹

27. Conversely, Internet banks will have little kinship with the communities to which their customers belong. If one defines “community” according to some notion of physical location, Internet banks will not, in most cases, share a community with their customer base.¹¹⁰ This will also be the case if the CRA denotes an Internet bank’s assessment area by the geographic origination of deposits.¹¹¹ For example, an Internet bank that locates its bank depository and computer maintenance operations in a small wealthy suburb may nonetheless have lower income Internet banking customers scattered throughout the United States. This likely disparity between an Internet bank and its customer communities will require a new approach in complying with the spirit and provisions of the CRA.

2. Internet Banks can Avoid Community Group Pressure

28. Thus far, one of the CRA’s most effective enforcement mechanisms has been organized pressure from community groups.¹¹² The threat of receiving a low CRA rating does not, by itself, pressure banks to comply with the CRA, because the vast majority of banks receive “satisfactory” ratings.¹¹³ In addition, regulators deny

¹⁰⁸ See David R. Johnson & David Post, *Law and Borders: The Rise of Law in Cyberspace*, 48 STAN. L. REV. 1367, 1370 (1996) (discussing how an Internet address can be entirely unrelated to the physical location of the server that holds the Web site’s information).

¹⁰⁹ See Security First Network Bank, *Deposits* (last modified Dec. 20, 1998) <http://www.sfnb.com/infodesk/caq_deposits.html>.

¹¹⁰ See Bloom, *supra* note 5, at 18 (reporting that Internet banks and Telebank, a telephone-based bank, do not focus their marketing efforts on particular geographical areas).

¹¹¹ See *id.* (stating that most of SFNB’s deposits originate from cities far from its physical location in Atlanta).

¹¹² See Fishbein, *supra* note 13, at 294 (arguing that community groups were necessary to enforce the CRA); Gary M. Swidler, *Making the Community Reinvestment Act Work*, 69 N.Y.U. L. REV. 387, 398 (1994) (describing how banks frequently make concessions to community groups in order to complete transactions with minimal negative publicity); GAO REPORT, *supra* note 3, at 31 (stating that regulators must consider community group protests when evaluating applications for expansions or mergers).

¹¹³ See GAO REPORT, *supra* note 3, at 26 (stating that since regulators made ratings public in July 1990, about 90% of institutions received at least a “satisfactory” CRA rating). Under the new regulations, there are five CRA rankings: “Outstanding,” “high satisfactory,” “low satisfactory,” “needs to improve,” and “substantial noncompliance in meeting community credit needs.” 12 C.F.R. § 25, App. A (1998) (detailing criteria for each ranking). Before the new regulations took effect on July 1, 1997, there were four possible rankings: “outstanding,” “satisfactory,” “needs to improve,” and “substantial noncompliance.” 12 U.S.C. § 2906(b)(2) (1994).

only the smallest fraction of bank expansion applications on the basis of poor CRA performance, though the law requires them to consider a bank's CRA rating.¹¹⁴

29. However, because FIRREA required banks to display their CRA ratings, the public, particularly community groups, have used the information to choose where to bank, or to lobby against a bank's application to open a new branch or to merge with other banks.¹¹⁵ According to CRA regulations, reviewers should consider community views, including those expressed in protests, when deciding to approve applications for new branches, relocation of main offices, mergers, and other transactions.¹¹⁶ Groups can lodge their protests when regulators invite public comment on bank applications.¹¹⁷ When community groups do protest, regulators will encourage banks and the community groups to compromise before the bank submits its application for approval.¹¹⁸

30. Community groups have successfully used these protests to achieve additional bank lending in low- to moderate-income communities.¹¹⁹ When community groups protest a bank's application for expansion, regulators hold hearings to address the bank's current and potential CRA performance.¹²⁰ The CRA's critics argue that an "outstanding" or a "satisfactory" rating does not prevent community groups from protesting bank applications.¹²¹ Faced with adverse publicity and both time and cost pressures to complete sensitive transactions, banks respond to these protests by offering to fund the community organizations' projects, or by pledging large amounts in community development loans over a period of

¹¹⁴ See GAO REPORT, *supra* note 3, at 30 (showing that of 41,311 applications from 1989-1994, regulators denied 17 on the basis of CRA performances).

¹¹⁵ See Fishbein, *supra* note 13, at 309; GAO REPORT, *supra* note 3, at 32.

¹¹⁶ See 12 C.F.R. § 25.29(a), (c).

¹¹⁷ See GAO REPORT, *supra* note 3, at 32.

¹¹⁸ See *id.*

¹¹⁹ See Fishbein, *supra* note 13, at 298-99. Negotiations between community groups and banks have resulted in banks making commitments of more than \$7.5 billion in loans and investments in their communities. See *id.* at 298. Lenders committed an additional \$23 billion to community development without explicit pressure from community groups while federal regulators deliberated on their requests to expand operations. See *id.* For example, in 1984, First National Bank of Chicago, Harris Trust and Savings Banks, and the Northern Trust Company collectively pledged \$153 million in investments over five years for single family and multi-family housing and small business loans as a result of negotiations with the Chicago Reinvestment Alliance (consisting of community groups and non-profit community development companies). See *id.* at 299. The banks later agreed to extend their commitments for an additional five years. See *id.*

¹²⁰ See Macey & Miller, *supra* note 16, at 323.

¹²¹ See *id.* at 334.

years.¹²² While critics and community groups disagree whether these protests are necessary,¹²³ they are rarely fatal to the bank's application¹²⁴ and often result in increased lending to communities.¹²⁵

31. An Internet bank is unlikely to feel pressure from community groups to invest in any of the many geographically disparate communities it may serve. Unless a bank heavily markets itself in specific areas, an Internet bank's customer base will be more a function of who has heard about its services and has Internet access than a function of where the customers reside. A geographically dispersed community is not likely to wage a successful and meaningful protest against an Internet bank's application to merge or expand. Because Internet banks lack a defined geographic community, regulators will have to shoulder the burden of enforcing the regulations without support from activist groups.

3. Internet Banks have a Competitive Advantage

32. Internet banks do not currently pose a threat to traditional banks' market share.¹²⁶ As their customer base and offered services grow, however, the banking industry will expect Internet banks to comply with the CRA in a manner commensurate with that of traditional banks.¹²⁷ Unless the CRA regulations are modified to encompass Internet banks and account for their geographic reach, these new banks will enjoy an undue competitive advantage over traditional banks, since regulators evaluate traditional bank efforts to provide credit services to the communities surrounding both their traditional branches and their deposit-taking facilities under the current CRA regulations.¹²⁸ The rationale for forcing Internet

¹²² See *id.* at 331-32, 335.

¹²³ See *id.* at 337 (calling the CRA "a fertile potential breeding ground for such improper influence" by self-interested local community activists); Tomes, *supra* note 74, at 233-34 (saying that regardless of validity, CRA protests greatly extend the amount of time required to complete a transaction); Fishbein, *supra* note 13, at 294 (stating that "local citizen monitors" play an important role in enforcing the CRA).

¹²⁴ See GAO REPORT, *supra* note 3, at 32 (showing that of 360 protested applications between 1989 and 1994, only 5 were denied).

¹²⁵ See *supra* note 119.

¹²⁶ See Bloom, *supra* note 5, at 18 (reporting that today only a handful of small banks operate solely on the Internet).

¹²⁷ See *id.* (labeling CRA compliance as a "second-generation Internet banking issue" and finding that deposits in Internet banks are still too low to warrant CRA enforcement).

¹²⁸ See *id.*

banks to comply with the CRA is similar to that addressed in the debate on whether to extend the CRA to non-bank lending institutions.¹²⁹

33. Banks have criticized the CRA because it only applies to traditional banks, stating that the limitation provides non-traditional lenders with an unfair competitive edge.¹³⁰ They contend that Congress should extend the CRA to non-bank entities for a number of reasons, including changes in the financial services industry that have resulted in mutual fund, brokerage, and other companies offering credit services.¹³¹ These non-traditional lenders now have more assets than banks and savings associations, and banks argue that these lenders benefit indirectly from federally insured deposits.¹³² At the time Congress enacted the CRA, banks benefited from a regulated, near monopoly in deposit services.¹³³ In recent years, banks have lost a significant share of the market to other financial institutions¹³⁴ and paid FDIC premiums at far less favorable rates than at the time of the CRA's enactment.¹³⁵ Thus, once Congress enacted the CRA, banks not only lost many of the regulatory benefits they enjoyed, but became disadvantaged compared to many of their non-bank competitors.¹³⁶

34. The unfair competition rationale for applying the CRA to non-traditional lenders also supports modifying the CRA to reach Internet banks. Internet banks today offer full-service, FDIC-insured depository services and products to customers

¹²⁹ See Macey & Miller, *supra* note 16, at 312 (arguing that the CRA places a disproportionate burden on depository institutions because it does not apply to other lending institutions such as pension funds, life insurance companies, consumer finance firms, mortgage banks, credit unions, and others).

¹³⁰ See *BankAmerica's Arguments for Putting Nonbanks Under CRA*, AM. BANKER, Sept. 28, 1993, at 12, 12 (reporting on BankAmerica Corp. chairman Richard Rosenberg's speech at a Federal Reserve Bank of Dallas conference regarding expanding the CRA's scope to include non-banks).

¹³¹ See *id.* (listing General Electric, Sears, and AT&T as some of the non-bank entities that operate subsidiaries that provide credit services).

¹³² See *id.* Rosenberg claimed that non-bank financial services companies held \$3 trillion in assets, \$1 trillion more than banks held in deposits. See *id.*

¹³³ See Macey & Miller, *supra* note 16, at 310.

¹³⁴ See *id.* at 310-11 (contrasting the current competition for deposits among financial institutions with the environment in the 1970's when regulations effectively barred banks from using interest rates to compete for deposits in checking and savings accounts).

¹³⁵ See *id.* at 311 (reporting that FDIC premiums grew "seven-fold" within the few years preceding the 1993 publication of Macey & Miller's article).

¹³⁶ See *id.* (arguing that some financial institutions should consider dropping their bank charters because having bank status may hinder them more than it helps).

across the United States.¹³⁷ Although their offices may be in a single location, geographic boundaries do not limit these banks when soliciting and accepting deposits.¹³⁸ At the same time, under the current CRA, Internet banks will only be responsible for defining as their assessment areas the small areas surrounding their physical offices.¹³⁹ Therefore, Congress should modify the CRA to account for the unique competitive advantage that Internet banks enjoy over traditional banks and must identify *how* these banks should invest in low- to moderate-income communities.

35. Professors Jonathan R. Macey and Geoffrey P. Miller discussed the possibility of applying the CRA to non-bank lenders in their article on the CRA, which argued that the CRA imposed a “discriminatory tax” on traditional banks and savings associations.¹⁴⁰ Because these other lenders served customers across extensive geographic areas without serving a defined “community,” they argued that the CRA was difficult to apply.¹⁴¹ Given the need to adopt a significantly different definition of community when measuring compliance, Macey and Miller found that extending the CRA to other lenders was unworkable and that the CRA worked as a tax, which harmed the competitive posture of traditional banks and savings associations.¹⁴²

36. When applying the current CRA’s definition of “community” to Internet banks, similar problems will arise. As discussed above, Internet banks take deposits from customers across the United States. Other than their deposit facilities and computer control centers, they do not have the physical presence of traditional banks. Therefore, while Internet banks share many of the characteristics of traditional banks, they resemble the non-bank lenders that compete with banks in their concentrated physical location. Although these other financial institutions have thus far escaped having to comply with the CRA, Congress should amend the statute to address this new facet of the financial services industry, in which traditional banks compete with non-traditional lenders and Internet banks that operate on a national basis without establishing a physical presence in the communities they serve.

¹³⁷ See discussion *supra* Part III.A.

¹³⁸ See Bloom, *supra* note 5, at 18 (reporting that SFNB’s depositors come from all over the United States).

¹³⁹ See 12 C.F.R. § 25.41 (1998).

¹⁴⁰ Macey & Miller, *supra* note 16, at 313.

¹⁴¹ See *id.* (finding that Congress could extend the CRA to geographically dispersed non-bank lenders “only if the ideology of community were dropped or extensively modified” to include non-geographically based communities, such as racial groups).

¹⁴² See *id.*

IV. DEFINING AN INTERNET BANK'S COMMUNITY AND MEASURING ITS CRA COMPLIANCE

37. This part will discuss several options for applying the CRA to Internet banks. The analysis is divided into two sections. The first section discusses how the CRA should define an Internet bank's community. It will review options according to the CRA's original purpose and subsequent criticisms of the statute. The second section considers how an Internet bank should serve its community. It will evaluate options for aligning Internet bank operations and the CRA's purposes and review whether Internet banks are amenable to performance measurement.

A. What "Community" Should an Internet Bank Serve?

38. Congress intended that the CRA encourage banks to provide credit services to their communities. Therefore, the first step in determining how the CRA should apply to Internet banks is to identify the community that they serve.

1. Traditional Approach: Bricks and Mortar

39. The first option, and the one which some Internet banks currently employ, is to define a bank's community as the geographic area directly surrounding its physical location.¹⁴³ This option is certain and complies with the text of the current CRA regulations.¹⁴⁴ This approach, however, will fail to meet the CRA's purposes because in most cases, the geographic location of the bank's customer base will not correspond to the bank's location.¹⁴⁵ This option is also undesirable because it fails to address criticism that the CRA evaluations focus too much on form and not enough on actual bank investment.¹⁴⁶ A defined geographic area corresponding to the bank's physical location will enable the bank to comply with the CRA's policy goals, but the discrepancy between the size of the bank's customer base and its CRA assessment area will cause severe understatements of the bank's actual CRA reinvestment obligations. To apply the CRA in a manner which effectively promotes community development, the community must bear some resemblance to the size of the bank's customer base.

¹⁴³ See Bloom, *supra* note 5, at 18 (noting that SFNB considers the area around Atlanta, its physical location, to be its CRA community).

¹⁴⁴ See 12 C.F.R. § 25.41 (1998).

¹⁴⁵ See Bloom, *supra* note 5, at 18 (stating that "the virtual community is unlikely to overlap with the community where the bank provides loan and deposit services").

¹⁴⁶ See, e.g., GAO REPORT, *supra* note 3, at 46.

2. Low- to Moderate-Income Individuals Across the U.S.

40. Regulators could dispense with local geographic definitions altogether and require banks to service and lend to low- to moderate-income individuals and small businesses across the United States. The regulators could use existing methods to identify which individuals and businesses would be eligible for these services.¹⁴⁷ This option would serve the CRA's goals because the recipients of Internet bank CRA benefits would originate from the same pool, or "community," as those who take advantage of Internet bank services. This option would also avoid creating an excessive paperwork burden on banks: there would be no need to continuously monitor where a bank's customer base resides to identify its communities. Internet banks would also benefit from the consistency of the geographic area against which the CRA would assess them, and their performance would be measured against similarly situated banks.

3. "Unbanked"¹⁴⁸ Recipients of SSI and Social Security Benefits

41. The Debt Collection Improvement Act of 1996¹⁴⁹ requires federal agencies to convert their payment methods from payment by check to electronic funds transfer ("EFT") by 1999.¹⁵⁰ This statute will affect the recipients of Supplemental Security Income ("SSI") and Social Security benefits who cannot receive EFT transactions because they do not have bank accounts.¹⁵¹ The Financial Management Service ("FMS") of the Department of the Treasury released proposed regulations to implement the EFT plan.¹⁵² Under the proposed regulations, the Treasury will provide recipients who do not have an account at a financial

¹⁴⁷ See 12 C.F.R. § 25.12(n) (1998) (delineating how the regulations identify low-, moderate-, middle-, and upper- income levels for each geographic area).

¹⁴⁸ The "unbanked" community of federal benefit recipients consists, in large part, of individuals who cannot afford bank accounts. See *Review of Proposed Regulations to Implement EFT '99: Hearing Before the House Comm. on Banking and Fin. Servs.*, 105th Cong. 55 (1997) (statement of Margot Saunders, Managing Attorney, National Consumer Law Center) (testifying on the impact of mandatory EFT payments on low-income federal benefit recipients).

¹⁴⁹ See 31 U.S.C. § 3332(e)(1) (Supp. II 1996).

¹⁵⁰ See *id.* § 3332(f)(1).

¹⁵¹ See *Electronic Funds Transfers for Federal Payments, 1997: Hearings on 31 U.S.C. 3332 Before the Subcomm. on Gov't Mgmt., Info. and Tech. of the House Comm. on Gov't Reform and Oversight*, 105th Cong. 180 (1997) (statement of Elliott C. McEntee, President and CEO, National Automated Clearinghouse Association) (stating that 91% of Social Security recipients and 50% of SSI benefit recipients have accounts with financial institutions).

¹⁵² See *Management of Federal Agency Disbursements*, 62 Fed. Reg. 48,714 (1997) (to be codified at 31 C.F.R. § 208) (proposed Sept. 16, 1997).

institution with an “Electronic Transfer Account” (“ETA”) at a designated FDIC-insured bank.¹⁵³ These financial institutions will act as the Treasury’s agent and provide recipients with access to an account for a reasonable cost.¹⁵⁴ Benefit recipients with ETA accounts will then access their funds through automatic teller machines and point-of-sale terminals.¹⁵⁵

42. The “unbanked” community could also serve as the collective community for Internet banks. The CRA could make Internet banks responsible for providing benefit recipients with ETA accounts to receive and manage their benefit payments. In comments to the proposed regulations, the FMS stated that the Treasury could choose its ETA agents through a competitive process.¹⁵⁶ Unless the FMS changes its proposal,¹⁵⁷ Internet banks, as federally insured financial institutions, could compete for designation as ETA financial agents. The unbanked federal benefit recipients comprise an identifiable national group, and the Internet banks could fulfill their CRA obligations by providing low-cost bank accounts to the recipients. Serving the unbanked would fulfill the CRA purpose of providing banking services to those who have had difficulty obtaining them in the past and would provide banks with an effective method to serve low- to moderate-income individuals.

4. Women and Racial Minorities

43. As discussed above, the Housing and Community Development Act of 1992 amended the CRA to encourage financial institutions to conduct business with women- and minority-owned depository institutions.¹⁵⁸ As amended, the CRA allows banks to meet regulatory obligations by contributing to the development of women- or minority-owned financial institutions.¹⁵⁹ Internet banks could define the

¹⁵³ *See id.* at 48,721.

¹⁵⁴ *See id.*

¹⁵⁵ *See id.*

¹⁵⁶ *See id.* The Treasury expects to choose designated agents and make these accounts available to benefit recipients by January 2, 1999. *See id.* at 48,721-22.

¹⁵⁷ The period for written comments ended Dec. 16, 1997. *See id.* at 48,714.

¹⁵⁸ *See* 12 U.S.C. §§ 2903, 2907 (1994); *see also supra* note 29 and accompanying text.

¹⁵⁹ Title 12, section 2903(b) of the United States Code provides:

In assessing and taking into account, under subsection (a) of this section, the record of a nonminority-owned and nonwomen-owned financial institution, the appropriate Federal financial supervisory agency may consider as a factor capital investment, loan participation, and other ventures undertaken by the institution in cooperation with minority- and women-owned financial institutions and low-income credit unions provided that these activities help meet the needs of local communities in which said

community they should serve under the CRA as women and minorities throughout the United States. This option, however, would prove unworkable on several levels. As a threshold issue, it is likely that such a classification would not survive a constitutional challenge. In 1995, the Supreme Court decided that federal racial classifications must be narrowly tailored to meet compelling governmental interests.¹⁶⁰ If a classification is challenged, a court could find that any effort to expand the gender and racial classifications of the Housing and Community Development Act of 1992 by applying the CRA to Internet banks is not narrowly tailored to the goal of increasing bank reinvestment in the community. In addition, there is considerable room for Internet users to misrepresent their race or gender in on-line applications.¹⁶¹ For example, Internet customers may take advantage of the anonymity of the Internet to apply for low cost loans from Internet banks. Lastly, a CRA compliance community of women and minorities covers a far broader benefit group than Congress intended.¹⁶² The "community" of women and racial minorities may include those who would not qualify as low- to moderate-income individuals under the existing CRA regulations. Therefore, attempting to comply with the CRA by serving women and minorities in general will prove unworkable for both the Internet banks and for regulators who must evaluate CRA compliance.

institutions and credit unions are chartered.

12 U.S.C. § 2903(b) (1994). Section 2907(a) provides:

In the case of any depository institution which donates, sells on favorable terms (as determined by the appropriate Federal financial supervisory agency), or makes available on a rent-free basis any branch of such institution which is located in any predominantly minority neighborhood to any minority depository institution or women's depository institution, the amount of the contribution or the amount of the loss incurred in connection with such activity may be a factor in determining whether the depository institution is meeting the credit needs of the institution's community for purposes of this chapter.

Id. § 2907(a).

¹⁶⁰ See *Adarand Constructors, Inc. v. Peña*, 518 U.S. 200, 227 (1995). The Supreme Court held that the federal government's financial incentives given to general contractors that hire small businesses run by "socially and economically disadvantaged individuals," as determined by "race-based presumptions," *id.* at 204, "must be analyzed by a reviewing court under strict scrutiny." *Id.* at 227. The Court held that the applicable standard of review under the Equal Protection Clause did not differ for "benign" racial classifications meant to benefit traditionally disadvantaged groups. See *id.*

¹⁶¹ See Michael P. Dierks, *Computer Network Abuse*, 6 HARV. J.L. & TECH. 307, 332 (1993) (discussing the difficulty of ascertaining computer users' actual identities, which are hidden behind their chosen login names).

¹⁶² See 12 U.S.C. § 2903(a) (1994) (requiring the regulatory agency conducting CRA evaluations to review the bank's record of serving "low- and moderate-income neighborhoods"). Compare Keith N. Hylton & Vincent D. Rougeau, *Lending Discrimination: Economic Theory, Econometric Evidence, and the Community Reinvestment Act*, 85 GEO. L.J. 237, 246 (1996), which concludes that Congress intended the CRA to combat racial discrimination in lending.

B. How Should Internet Banks Comply with the CRA?

44. Traditional compliance with the CRA entails providing loans to low- to moderate-income individuals and small businesses within the bank's geographic area, investing in the bank's community, and developing retail banking and other community-oriented services.¹⁶³ Regulators may require Internet banks to comply through similar methods, but they will run into difficulties when assessing the banks' performances in any of these areas. Internet bank customers are those with access to computers with on-line connections.¹⁶⁴ Therefore, it is unlikely that those who will seek loans through Internet banks will fit the low- to moderate-income profile enumerated in current CRA regulations.¹⁶⁵ Until Internet access to banking services becomes more widespread, Congress should consider allowing Internet banks to fulfill their CRA obligations through non-traditional means.

1. PC Access and Training

45. As of now, the low- to moderate-income individuals who benefit from the CRA are those who are least likely to have access to and actively utilize the Internet.¹⁶⁶ In modifying the CRA, Congress could allow Internet banks to comply with the CRA by providing PC access and training to low- to moderate-income individuals and families. While this option does not provide increased credit to underprivileged communities, it would help to remedy the lack of access low- and moderate-income individuals have to the technology used to apply for loans on-line. Regulators could measure compliance by assessing the size of an Internet bank's financial and time investment in improving access to Internet banking, compared to other Internet banks.

46. This option, however, has the potential to aggravate bankers' concerns regarding excessive paperwork by imposing a burden on Internet banks to provide a service that is tangentially related to banking. In addition, the range of compliance options available to Internet banks under this method would most likely lead to inconsistent CRA evaluations, because an Internet bank's performance would be determined entirely by comparison with the performance levels of other Internet banks. Although this option would improve Internet access, regulators would need

¹⁶³ See 12 C.F.R. §§ 25.22-25.24 (1998).

¹⁶⁴ See Bloom, *supra* note 5, at 18 (noting that a computer with Internet banking capabilities is beyond the financial reach of many Americans).

¹⁶⁵ See 12 C.F.R. § 25.12(n).

¹⁶⁶ See *The Poor Need High Tech*, L.A. TIMES, May 20, 1996, at B4, B4 (showing that one in ten low-income students had a computer at home, compared to eight in ten affluent students).

to narrow the compliance standards for Internet banks so that the banks could provide an appropriate level of services.

2. Loans to Low- to Moderate-Income Individuals and Small Businesses

47. Regulators could require Internet banks to set aside a given amount of loans for low- to moderate-income individuals seeking to purchase their first home or for individuals wanting to start a small business. This option would further the CRA's purpose by ensuring that Internet banks, like their traditional counterparts, offer loans to economically disadvantaged individuals. An Internet bank's performance could be measured against the percentage loan target set for the bank as a function of its size and in relation to other Internet banks.¹⁶⁷

48. Industry representatives and regulators considered setting quantitative targets for lending as a CRA compliance method, but rejected the proposal because they found it was too close to credit allocation, which would infringe too strongly on a bank's prerogative to decide when to issue loans.¹⁶⁸ Regulators and bankers felt that setting lending requirements for low- to moderate-income individuals would exceed the CRA's purpose of encouraging banks to make lending decisions that were consistent with normal bank operations.¹⁶⁹ In addition, setting targets requires banks to prepare, and regulators to review, substantial quantities of data.¹⁷⁰ One of the strongest criticisms of the CRA is its over-dependence on data reporting to the government.¹⁷¹ Therefore, if the CRA requires Internet banks to make a certain percentage of their loans to low- to moderate-income individuals, it will face criticism that its scope exceeds Congress's original intent when enacting the CRA.

¹⁶⁷ Regulators could require that Internet banks make a certain percentage of their loans to low- to moderate-income individuals and small businesses. Regulators could set appropriate percentages for Internet banks based on their asset size. For example, an Internet bank holding assets of \$100 million would be responsible for making 5% of its loans to low- to moderate-income individuals and small businesses, whereas a bank holding assets of \$1 billion would make 10% of its loans to that group.

¹⁶⁸ See Claudia Cummins, *Fed Criticizes Clinton Plan on Overhaul of the CRA*, AM. BANKER, Dec. 13, 1993, at 1, 3 (describing how the Federal Reserve Board criticized CRA revisions that they felt went beyond encouraging banks to lend in poor areas); William M. Isaac, *Reform of CRA Ought to Be Guided by Its Original Purpose*, AM. BANKER, Mar. 30, 1994, at 16, 16 (stating that regulators specifically rejected quantitative targets when implementing the original CRA regulations because they felt that such targets would lead to "credit allocation and uneconomic investment decisions").

¹⁶⁹ See Cummins, *supra* note 168, at 3.

¹⁷⁰ See *id.* (reporting that the Federal Reserve Board found that the intensive data preparation requirements would be "very costly" for banks).

¹⁷¹ See GAO REPORT, *supra* note 3, at 45 (finding that regulators, bankers, and community groups agreed that CRA evaluations over-emphasized paperwork).

3. Subsidies for Affirmative, Effective Compliance Efforts

49. In their article on the CRA, Professors Keith N. Hylton and Vincent D. Rougeau suggest that subsidies may be the most effective means of implementing the CRA.¹⁷² They found that the CRA's effectiveness depends too heavily on a bank's plans to open new branches or merge with other banks.¹⁷³ To achieve the CRA's goals, Hylton and Rougeau argue that the government should offer subsidies to those banks that comply, while not punishing those that do not.¹⁷⁴ They suggest that the subsidy could take the form of relief from other regulatory burdens imposed on banks.¹⁷⁵ This proposal could raise CRA compliance while lowering the administrative costs of reviewing every bank's level of performance.¹⁷⁶

50. The subsidy model and its rationale apply equally well to Internet banks. Internet banks will not open new branches, though they may at some point want to merge with both on-line and traditional banks. As discussed above, Internet banks are also unlikely to encounter protests from community groups when they announce pending mergers or other transactions. The subsidy model, however, could encourage Internet banks to make contributions to the community regardless of their plans for growth and regardless of the lack of protest from the community.

51. Through the subsidy model, regulators could allow Internet banks latitude in deciding how to serve their community. For example, Telebank, a bank offering its services over the telephone,¹⁷⁷ chose to comply with the CRA by targeting both its local and national communities.¹⁷⁸ Locally, the bank offers internships to area high school students; nationally, the bank purchases mortgages from lenders in low- and moderate- income communities across the United States.¹⁷⁹ Regulators could measure the extent of an Internet bank's contribution to its

¹⁷² See Hylton & Rougeau, *supra* note 162, at 282 (concluding that the present "penalty" approach to CRA enforcement involved excessive costs for banks).

¹⁷³ See *id.* at 280-81. The CRA encourages banks to balance the benefits of expansion against the cost of incurring CRA obligations in the new locations, causing banks to forego expansion in minority neighborhoods if the CRA costs will outweigh the benefits. See *id.*

¹⁷⁴ See *id.* at 282-83 (suggesting that subsidies could take the form of "safe harbor treatment" in exchange for meeting high CRA compliance criteria, or regulators could offer subsidies to lending institutions with a history of high CRA scores).

¹⁷⁵ See *id.* at 283 (suggesting that regulators could allow banks to offer formerly forbidden products, such as insurance).

¹⁷⁶ See *id.* at 282.

¹⁷⁷ See Bloom, *supra* note 5, at 18.

¹⁷⁸ See *id.*

¹⁷⁹ See *id.*

community by comparing the amount of the Internet bank's financial and time investments compared to the bank's size and total assets. As Internet banks become more established, regulators can reassess CRA compliance methods and perhaps adopt one or more of the creative compliance efforts promulgated by an Internet bank. Therefore, the subsidy model is flexible enough to accommodate the differences between Internet and traditional bank operations without aggravating the problems identified with past CRA compliance.

52. A further benefit of the subsidy model is its applicability to nontraditional lending institutions such as mutual fund companies and brokerages. Regulators can structure the subsidies to provide incentives that encourage nontraditional lenders to make community development investments. If the subsidy approach proves workable for encouraging community investments by Internet banks, Congress could expand the CRA's scope to nontraditional lenders. Applying a subsidy approach across the board to all lending institutions would further the CRA's goals and remove regulatory advantages currently enjoyed by Internet banks and nontraditional lenders.

V. CONCLUSION

53. Internet banks pose a significant challenge to the application of the Community Reinvestment Act. Unlike traditional banks, Internet banks do not have a defined community and escape policing by community watchdog groups, which is a powerful enforcement method. Internet banking is still in its infancy, and the banks have not yet posed a competitive threat to traditional banks. However, on-line banking has grown steadily in the last few years and industry experts expect the trend to continue. Therefore, regulators should begin to evaluate options for defining an Internet bank's community and for determining how these banks should comply with the spirit of the CRA. In weighing the options, regulators should analyze how each option furthers the CRA's purpose without aggravating existing problems concerning the statute's implementation. To this end, this Note suggests that the CRA should define an Internet bank's community as low- to moderate-income individuals or the "unbanked" federal benefit recipients across the United States and should encourage Internet bank investments in these communities by providing subsidies for Internet banks. These compliance methods would further the CRA's purpose without depending upon community protest for implementation and without imposing excessive data reporting requirements on the banks. By applying the CRA to Internet banks through the subsidy approach and bringing nontraditional lenders under the rubric of the CRA, Congress and regulators will be able to bring additional benefits to deserving communities while ensuring that Internet banks and nontraditional lenders do not have an undue competitive edge over their traditional counterparts.