CHASM | Centre on Household Assets and Savings Management

Briefing Paper

Why the UK needs a Community Reinvestment Act (CRA)

The controversial Vickers report, published in Autumn 2011, outlines how reforming the banking sector aims to increase competition for business banking whilst also increasing the stability of banks[1]. One of the key reasons for reform was to drive banks to lend to small-and-medium-sized enterprises (SMEs). Yet as I have suggested elsewhere[2], the impact of Project Merlin on access to enterprise finance is likely to be limited due to the temporary lending target which the banks have failed to reach. Perhaps this is a result of the banks' lack of appetite for risk, a lack of confidence by firms to invest, or both. However, figures recently released by the Office of National Statistics (ONS)[3] suggest that banks have rejected increasing numbers of businesses seeking finance since the financial crisis began in 2007. So if banks are currently unwilling and/or unable to lend to SME market, what will make them or who will?

Community Development Finance Institutions (CDFIs) are well placed to act as a vehicle in which banks could lend just as in the US under the guidance of the Community Reinvestment Act (CRA)[4]. The CRA was introduced in the US in 1977 to drive lending in underserved communities as a result of racial discrimination and red-lining by mainstream banks (where banks would map geographic areas in which they would not serve)[5]. A UK

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[1] Independent Commission on Banking (2011) Final Report: recommendations. http://bankingcommission.independent.gov.uk/

[2] See CHASM briefing paper 'Community Development Finance Institutions (CDFIs): credit where its due'

[3] ONS (2011) 'Access to finance 2007 and 2010'. Available at: http://www.ons.gov.uk/ons/rel/fi/access-to-finance/2007-and-2010/stb-access-to-finance.html

[4] For more on CDFIs see CHASM briefing paper on 'Community Development Finance Institutions (CDFIs): credit where its due'

[5] Appleyard, L. (2011), 'Community Development Finance Institutions (CDFIs): Geographies of Financial Inclusion in the US and the UK'. *Geoforum,* 42(2) 250-258.

CRA would first, force banks to lend to SMEs (via CDFIs who would be responsible for the pre-, during- and post-loan process, and shoulder the risk with policy guarantee funding) and second, make banks lending more transparent. Banks would also refer those that were denied access to finance to CDFIs. A UK CRA could also divert bank funding which they would have lent to SMEs to CDFIs and make extra resources available for CDFIs to cope with referrals of rejected bank customers and take on additional geographical coverage, underserved markets and risk beyond disadvantaged areas as the nature of financial exclusion changes[6].

The current UK CDFI funding situation is piecemeal and needs to be widened to include all sectors and geographic areas (including Scotland and Wales). A UK CRA would clarify the roles and responsibilities of banks and CDFIs. Without significant public policy support it is unlikely that CDFIs will become part of the longer term financial landscape. This would be a tragic loss given the knowledge and expertise in delivering loans to viable SMEs that create and/or preserve jobs as a result of accessing finance. The Government needs to prioritise the growth agenda to generate jobs in the short-term for long-term stability for individuals, households and businesses which could be addressed through CDFIs and a CRA.

A UK CRA cannot be viewed as 'a panacea for financial exclusion' due to the complex nature of financial exclusion in the UK[7]. Yet without collaboration and co-operation between financial institutions, under the regulation of a UK CRA, it is likely that financial exclusion of enterprise will increase further and the economy will continue to suffer as a result.

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[6] See CHASM briefing paper on 'Redefining financial inclusion in the wake of the financial crisis'
[7] Marshall, J. N. (2004) 'Financial institutions in disadvantaged areas: a comparative analysis of policies encouraging financial inclusion in Britain and the United States'. *Environment and Planning A,* 36, 241-261.