The Community Reinvestment Act Proposal: Ten Things To Know

On December 12, 2019, the Office of the Comptroller of the Currency ("OCC") and Federal Deposit Insurance Corporation ("FDIC") released a notice of proposed rulemaking to overhaul the agencies' regulatory framework for evaluating banks' Community Reinvestment Act ("CRA") performance. The proposal follows a 2018 advance notice of proposed rulemaking by the OCC, and if finalized, would constitute the first major set of revisions to the CRA framework in nearly 25 years.

1 The core of the proposal is its establishment of a new evaluation framework with three objective measurements of CRA performance.

In lieu of the current CRA regulations' Lending, Investment, Service, and Community Development tests, the proposal's new general framework would evaluate a bank's CRA performance within each assessment area and at the bank level using three measures: (1) a **CRA evaluation measure** that divides the dollar value of the bank's **qualifying activities** (including retail loans to low- or moderate-income ("LMI") individuals, small loans to businesses in LMI geographies, and community development ("CD") loans, investments, and services), by the value of the bank's **retail domestic deposits** (excluding deposits sourced from deposit brokers), and adds a positive adjustment based on the proportion of the bank's branches located in LMI geographies; (2) a **retail lending distribution measure** that evaluates the distribution of the number of the bank's loans in a **major retail lending product line** (i.e., a retail lending product line that comprises at least 15 percent of the bank's retail originations by volume) using a **geographic distribution test** for small loans to businesses and farms and a **borrower distribution test** for home mortgages, consumer loans, and small loans to businesses and farms; and (3) a **CD minimum** that requires the total amount of CD loans and CD investments divided by retail domestic deposits to be not less than 2 percent. The three measures would generate a **presumptive rating**, which the agencies could adjust upward or downward based on a consideration of **performance context** factors, or downward based on evidence of discriminatory or other illegal credit practices. Appendix A includes a step-by-step summary of the methodology for determining a bank's rating under the proposed framework.

---

2 Small banks could continue to be evaluated under the existing framework for small banks that are not intermediate small banks.

The proposal would give a bank with $500 million or less in assets the option to be evaluated under the new evaluation framework or the current CRA regulations' evaluative framework for small banks that are not intermediate small banks. A bank would need to make this choice at least six months before the start of the evaluation period.

---

3 The proposal would maintain emphasis on branch networks and in-assessment area performance, and could expand that emphasis to additional geographies from which a bank sources deposits.

Under the proposal, a bank would designate **facility-based assessment areas**, which would be similar to the existing branch-based assessment areas as designated under the current CRA regulations. A bank that sources 50 percent or more of its retail domestic deposits from outside its facility-based assessment areas would also be required to designate **deposit-based assessment areas** that include the non-overlapping geographies in which the bank sources 5 percent or more of its retail domestic deposits.

4 The list of activities that receive CRA credit would be clarified and significantly expanded.

To give banks more certainty that their activities will or will not receive credit under the CRA evaluation measure, the proposal would establish detailed criteria for qualifying activities, a list of examples of qualifying activities, and a process for banks to seek confirmation from the agencies that an activity is a qualifying activity. The agencies would update the list of examples on their websites as they confirm new activities to be qualifying activities, and codify changes every three years through a notice-and-comment process. Qualifying activities would notably include activities supporting community support services (including child care, education, and health services), essential community facilities, and essential infrastructure that serve LMI individuals, naturally occurring affordable housing, rental housing for LMI individuals residing in high-cost areas, and activities in Indian country. Banks could receive pro rata credit for activities that partially, but not exclusively, benefit LMI individuals, such as financing mass transit that serves LMI neighborhoods and other geographies. Additionally, the proposal would double the value of qualifying activities involving community development financial institutions ("CDFIs"), CD investments (not including mortgage-backed securities or municipal bonds), and other affordable housing-related CD loans in order to provide additional incentives for banks to engage in those activities.

5 Certain activities that currently receive CRA credit would no longer qualify for credit, in full or in part.

Under the current CRA regulations, loans to individuals of any income level who reside in LMI geographies can receive credit under the Lending Test. Citing concerns that the current rules may contribute to displacement of residents of these geographies, the agencies have proposed to allow only those individual loans that are made to an LMI borrower (or to any borrower in Indian country) to receive credit under the new evaluation framework. Additionally, the current CRA regulations and guidance generally fully count loans purchased or originated during the evaluation period, which can result in multiple banks receiving CRA credit for the same loan. The proposal would address this treatment by counting the annual value of loans and investments on a monthly average basis, meaning that a bank that holds a CD investment for one month would receive credit for one-twelfth of the value of the investment for that year, and by counting one-fourth of the value of a qualifying loan that the bank originated and held on the balance sheet for less than 90 days.

6 The evaluation framework for banks with specialized business models would change significantly.

The proposal would eliminate the limited purpose and wholesale designations that currently allow certain narrow-focused banks to forego evaluation of their primary business lines and satisfy their CRA obligations solely through community development activities, typically in the area surrounding their main office. Under the proposal, these banks would be subject to the same standards that apply to full service banks, including the retail lending distribution measure. For a bank engaged in consumer lending as a major retail lending product line, this measure would evaluate the income distribution of its loans to individuals in its assessment areas, and for a bank engaged in small loans to businesses as a major retail lending product line, this measure would evaluate the geographic distribution of such loans to businesses located in LMI geographies within its assessment areas as well as the proportion of small loans made to small businesses in its assessment areas. However, a bank that generates loan opportunities through nonbank partners or digital channels, and/or uses automated underwriting standards, may not be able to alter its credit distribution patterns in particular assessment areas as easily as a bank that relies on branches. Further, the proposal's requirement for certain banks to have deposit-based assessment areas could result in many narrow-focused banks having more, and potentially non-contiguous, assessment areas than they do today. These changes could lead to more widespread adoption of strategic plans, which allow a bank to customize its own performance targets with input from the public.

7 Some elements of the current CRA framework would stay largely intact.

Despite being a focus of some industry comments in response to the 2018 OCC ANPR, the standards for downgrading a bank based on evidence of discriminatory or other credit practices would not fundamentally change in the proposal. In fact, the proposal would expand the list of legal violations that can trigger such a downgrade to include violations of the Military Lending Act and Servicemembers Civil Relief Act. Likewise, the agencies have not proposed to change materially the requirements for a strategic plan.

8 Outstanding ratings would be rewarded.

The preamble to the proposal states that a bank with an Outstanding rating would presumptively earn a CRA evaluation period of five years, and seeks comment on additional ways to incentivize banks to achieve Outstanding ratings.

9 Banks would need to maintain voluminous records and report new data.

The proposal would impose significant recordkeeping requirements requiring the collection and maintenance of essentially all data supporting the bank's performance on the three evaluation measures. On an annual basis, a bank subject to the three evaluation measures would need to report, among other things, the quantified value of its qualifying retail loans, CD loans, CD investments, and CD services for the annual period, and the agencies would make this data public. Additionally, the proposal's retail lending distribution measure would require the agencies to maintain significant amounts of new data on the characteristics of assessment areas and bank lending patterns within particular product lines and geographies. It is unclear whether banks would have access to this data prior to their first evaluations under the new framework, and a lack of advance access could make it challenging for banks to plan their CRA strategies for the first evaluation period.

10 The prospects for finalization at the three federal banking agencies are uncertain.

Given the importance of the CRA in determining the amount, type, and distribution of credit by banks to LMI individuals and neighborhoods, the proposal has received significant attention from community groups and Democratic members of Congress. House Financial Services Committee Chairwoman Maxine Waters took the unusual step of attending the meeting at which the FDIC board approved the proposal in order to demonstrate to the board that the Committee is "very carefully monitoring [its] activities."

Notably, the Federal Reserve did not join the proposal. In comments following a December 12, 2019 FOMC meeting, Chair Jerome Powell stated that the Federal Reserve "worked very hard to try to get aligned with the OCC . . . and my hope is that we can still do that. . . . If we can't [reach agreement] I'm not sure what the path forward would be, but we would certainly not want to create confusion or a sort of tension between the regimes if they do turn out to be slightly different regimes. . . . So that's something I hope we don't have to face, but we will if we have to."

Appendix A: Step-by-Step Summary of Proposed Ratings Mechanics

Step 1: Designation of Assessment Area(s)

The scope of a bank's assessment area(s) is determined through two tests:

Facility-Based Assessment Area: Every bank must delineate an assessment area encompassing each location where it maintains its main office, a branch, or a non-branch deposit-taking facility, as well as the surrounding locations in which the bank has originated or purchased a substantial portion of its qualifying retail loans.

Deposit-Based Assessment Area: A bank that receives 50 percent or more of its retail domestic deposits from outside of its facility-based assessment area must delineate separate, non-overlapping assessment areas in the smallest geographic area where it receives 5 percent or more of its retail domestic deposits.

Step 2: Determination of Assessment Area-Level Presumptive Rating

The bank's presumptive assessment area-level rating is determined by its CRA Evaluation Measure, and a Satisfactory or better rating also requires passing the Retail Lending Distribution Measure and satisfying the CD Minimum.

CRA Evaluation Measure: The bank's assessment area-level CRA Evaluation Measure is the sum of: (1) the dollar value of qualifying activities, divided by the average quarterly value of the bank's assessment area retail domestic deposits; and (2) the percentage of branches in the assessment area that are located in LMI census tracts, multiplied by 0.01. The value of certain CD activities is multiplied by two for the purposes of this measure. This measure must meet or exceed 11 percent for an Outstanding rating, 6 percent for a Satisfactory rating, and 3 percent for a Needs to Improve rating in the assessment area.

Retail Lending Distribution Measure: The bank must (1) pass a borrower distribution test for each major retail lending product line for which a bank has originated 20 or more loans in the assessment area during the evaluation period, and (2) when making small loans to businesses or farms is a major retail lending product line and the bank has originated 20 or more such loans in the assessment area during the evaluation period, pass the geographic distribution test for such loans. These tests measure the number of loans that the bank has made, rather than the dollar value of those loans.

- Under the borrower distribution test, the percentage of the bank's loans in a given category in the assessment area that the bank has made to LMI individuals, small businesses, or small farms (as applicable) must exceed either (a) 55 percent of the percentage of individuals in the assessment area who are LMI, or percentage of businesses or farms in the assessment area that are small businesses or small farms (as applicable), or (b) 65 percent of the percentage of peer banks' loans in the category in the assessment area that peer banks have made to LMI individuals, small businesses, or small farms (as applicable).
- Under the geographic distribution test, the percentage of the bank's small loans to businesses or farms in the assessment area that the bank has made in LMI census tracts must meet or exceed either (a) 55 percent of the percentage of businesses or farms in the assessment area that are in LMI census tracts, or (b) 65 percent of the percentage of peer banks' loans to businesses or farms in the assessment area that peer banks have made in LMI census tracts.

CD Minimum: The value of the bank's CD loans and investments in the assessment area divided by the average quarterly value of the bank's assessment area retail domestic deposits must meet or exceed 2 percent.

Step 3: Determination of Bank-Level Presumptive Rating

The bank's presumptive bank-level rating is determined by its bank-level CRA Evaluation Measure and its assessment area ratings, and a Satisfactory or better bank-level rating also requires satisfying the bank-level CD Minimum.

CRA Evaluation Measure: The CRA Evaluation Measure described in Step 2 is also used to evaluate the bank's total qualifying activities both within *and* outside of its assessment areas to calculate the bank-level CRA Evaluation Measure. The average of the annual bank-level CRA Evaluation Measures during the evaluation period must meet or exceed 11 percent for an Outstanding rating, 6 percent for a Satisfactory rating, and 3 percent for a Needs to Improve rating.

Assessment Area Ratings: The bank must receive a given rating in a "significant portion" of its assessment areas (which the preamble suggests is 50 percent or more) to receive that same rating at the bank level.

CD Minimum: The value of the bank's total CD loans and investments (both within *and* outside its assessment areas) divided by the average quarterly value of the bank's retail domestic deposits must meet or exceed 2 percent.

Step 4: Application of Performance Context Factors

The bank's primary federal regulator may adjust its presumptive assessment area-level and bank-level ratings based on a series of performance context factors. These factors include the bank's explanation of its product offerings, business strategy, financial constraints, economic factors, and assessment area needs.

Evidence that the bank has engaged in discriminatory or other illegal credit practices may also provide grounds for a downward ratings adjustment.

For further information or details on this topic, please contact:

Michael Nonaka
Washington
+1 202 662 5727
mnonaka@cov.com

Karen Solomon
Washington
+1 202 662 5489
ksolomon@cov.com

Jeremy Newell
Washington
+1 202 662 5569
jnewell@cov.com

Randy Benjenk
Washington
+1 202 662 5041
rbenjenk@cov.com

Jenny Scott Konko
Washington
+1 202 662 5025
jkonko@cov.com

B. Graves Lee
Washington
+1 202 662 5722
blee@cov.com