The Federal Reserve's Advance Notice of Proposed Rulemaking on Community Reinvestment Act Reform:
Ten Things To Know

On September 21, 2020, the Board of Governors of the Federal Reserve System ("Board") released an advance notice of proposed rulemaking ("ANPR") to solicit views on potential changes to the Board's regulations implementing the Community Reinvestment Act ("CRA") for state-chartered member banks. The Board's issuance of the ANPR follows the May 2020 release of a final rule by the Office of the Comptroller of the Currency ("OCC") that substantially reforms the OCC's CRA regulations, which apply to national banks and federal savings associations.

At 186 pages long and with 99 questions requesting feedback from public commenters, the Board's release is unusually detailed for an ANPR. As described in this client alert, these details highlight both clear similarities and differences with the approach taken in the OCC's final rule and could position the Board's approach to serve as a starting point if the federal banking agencies renew discussions to develop a common approach to CRA reform.

Comments on the ANPR are due 120 days from the date of its publication in the Federal Register. To make any changes to its CRA regulations, the Board will first need to issue a notice of proposed rulemaking, followed by a final rule.

1 The Board's ANPR would establish separate tests to evaluate retail lending and community development activities, and not the single ratio of performance established in the OCC's final rule.

The ANPR indicates that the Board is considering measuring the CRA performance of a state member bank that is not a small bank, wholesale bank, or limited purpose bank through two main tests, the Retail Test and the Community Development ("CD") Test, each with two subtests. The Retail Test would consist of a Retail Lending Subtest that evaluates the income and geographic distribution of a bank's retail lending borrowers and a Retail Services Subtest that evaluates the responsiveness of a bank's delivery systems and deposit products to the needs of low- and moderate-income ("LMI") communities. The CD Test would consist of a CD Financing Subtest that evaluates the amount and impact of a bank's CD loans and qualified investments and a CD Services Subtest that evaluates the impact of CD services.

A bank would receive ratings for its performance on each of these tests and subtests, and all of those ratings would directly influence a bank's overall CRA rating. In contrast, the OCC's final rule incudes several pass/fail tests, but assigns a bank's overall CRA rating largely based on performance under a single metric, the CRA Evaluation Measure.

2 The Retail Lending Subtest and CD Financing Subtest would primarily be quantitative in nature, similar to aspects of the OCC's final rule.

The Retail Lending Subtest would evaluate the distribution of a bank's retail lending in a given assessment area across two dimensions: a geographic distribution metric that would evaluate the bank's proportion of originated and purchased loans to borrowers located in LMI census tracts in the assessment area, and a borrower distribution metric that would evaluate the bank's proportion of originated and purchased loans to LMI borrowers, small businesses, and small farms in the assessment area overall, regardless of geography. For both metrics, the bank's performance would be compared to (1) local demographics (*e.g.*, the proportion of owner-occupied residential units in LMI census tracts) in a "community benchmark" that would be similar to the OCC's "demographic comparator," and (2) the comparable proportion reported by all reporting lenders in the assessment area in a "market benchmark" that would be similar to the OCC's "peer comparator." The Board would set the level for satisfactory presumptive performance on the subtest at 65 percent of the community benchmark and 70 percent of the market benchmark. Similar to the OCC's final rule, the ANPR would allow a bank to receive a presumptive rating of satisfactory by satisfying either metric. The Board's version of this subtest would also assign performance ratings (outstanding, satisfactory, needs to improve, or substantial non-compliance) using similar benchmarks, together with performance context factors that examiners would consider.

A bank would be required to have a sufficient amount of retail lending activity in an assessment area, relative to the amount of deposits from the assessment area, to be eligible for the metrics-based approach described above. If a bank did not meet that threshold, its retail lending performance in the assessment area would be subject to a more manual review by examiners. The OCC's final rule has no comparable evaluation element.

The ANPR's other quantitative metric, the CD Financing Subtest, would measure the ratio of a dollar amount of a bank's CD loans and qualified investments in a given assessment area to the dollar amount of a measure of deposits within the assessment area. The Board is considering two methods for determining the denominator: one would count all deposits booked to branches in the assessment area, as reported in the FDIC's Summary of Deposits Data, and the other would count retail domestic deposits held on behalf of depositors residing in the assessment area; the latter would be similar to the denominator of the OCC's final rule's CRA Evaluation Measure and Community Development Minimum but would require banks to collect new data. Examiners could assign loans and investments "impact scores" that would be similar to multipliers in the OCC's final rule. The Board would then compare the bank's ratio to analogous market benchmarks at the local level and the national level.

The Retail Lending Subtest and CD Financing Subtest would each carry greater weight in a bank's overall rating than the more qualitative Retail Services Subtest and CD Services Subtest, respectively.

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3 The ANPR would retain and expand upon qualitative approaches to evaluating services, with an emphasis on branch networks and deposit products.

The ANPR would include more qualitative elements than the OCC's rule, particularly in the evaluation of a bank's services under the Retail Services Subtest and CD Services Subtest.

The Retail Services Subtest would include two components. First, examiners would evaluate a bank's delivery systems based on:

- the proportion of the bank's branches in LMI census tracts;
- the extent to which the bank's branch-based services improve access to financial services, including by offering extended hours of operation, accessibility to disabled or non-English speakers, and/or low-cost remittance and payroll check cashing services; and
- the responsiveness of non-branch delivery channels, as assessed based on their cost, ease of use, and rate of adoption by LMI individuals.

Second, examiners would evaluate whether a bank's deposit product offerings meet the needs of LMI consumers. The ANPR lists examples of products responsive to the needs of LMI consumers, including low-cost transaction accounts accessible through debit cards or general-purpose reloadable prepaid cards, accounts with low or no monthly opening deposit or balance fees, and accounts with low or no overdraft and insufficient funds fees (NSFs).

The Board is also considering requiring banks over a certain size (either $10 or $50 billion or more in assets) to provide a strategic statement articulating how they intend to offer deposit products responsive to the needs of LMI communities and individuals. Also under consideration is whether the strategic statement should be part of a bank's public CRA file.

The CD Services Subtest would involve a qualitative review of a bank's CD services that could be informed by quantitative metrics, such as the number and hours of CD services, and an impact score that an examiner would assign based on the perceived impact of the service. While this approach would be similar to the Service Test in the Board's current CRA regulations, the ANPR states that the Board is considering broadening the types of services that would count, including to capture services provided in rural areas that are not related to financial services or do not have community development as their primary purpose, and financial literacy and housing counseling services that benefit individuals of any income level.

Through these subtests and other qualitative elements of the framework under consideration, the ANPR would preserve a substantial role for examiner judgment in the Board's administration of the CRA.

4 The ANPR reflects the Board's desire to use existing data sources to the extent possible.

Several of the differences in approach between the ANPR and the OCC's final rule reflect the Board's stated interest in using data that banks already report or are otherwise publicly or commercially available.

For example, the Board would use data from the U.S. Census Bureau, Home Mortgage Disclosure Act (HMDA) reports, and a commercial provider to generate many of the assessment area-level benchmarks under the Retail Lending Subtest. In contrast, the OCC's Retail Lending Distribution Test imposes new data reporting requirements on many OCC-regulated banks for purposes of generating demographic and peer comparators.

Similarly, the Board is considering allocating deposits to census tracts using existing FDIC Summary of Deposits data that reflect the bank's booking of deposits to its branches, rather than requiring banks to geocode the residence of each depositor, as the OCC has done.

5 Compared to the OCC's final rule, the ANPR indicates that the Board would use a wider range of thresholds, weighted averages, and other tools to tailor a bank's evaluation and rating to its geographic and product focus.

There are several ways in which the ANPR would tailor the CRA framework to a bank's business model and reduce the impact of geographies and products that are less significant to a particular bank on its rating:

- The Board is considering subjecting any retail lending product line that constitutes 15 percent or more of the dollar volume of a bank's retail lending within a given assessment area to the Retail Lending Subtest in that assessment area. By comparison, the OCC's final rule contains a similar 15 percent test, but applies it at the bank level, meaning that a retail lending product line that reaches or exceeds the threshold is potentially subject to evaluation in each of the bank's assessment areas.
- The Board is also considering applying its existing CRA regulation's "substantial majority" threshold to determine whether consumer loans should be evaluated under the Retail Lending Subtest. The ANPR does not set forth a proposed denominator for the "substantial majority" threshold (*e.g.*, total assets, total loans, or total retail loans), nor a specific percentage that would constitute a "substantial majority," though in a different context the ANPR suggests that the term means 75 percent or more.

- The Board is considering assigning ratings for the Retail Lending Subtest based on the weighted average of performance for all products that are evaluated under that subtest, rather than subjecting each product to a separate pass/fail test as in the OCC's final rule.
- To determine a bank's institutional-level Retail Test rating, the Board would calculate the weighted average of the bank's assessment area-level Retail Test ratings, with the weighting based on the average percentage of loans and deposits that the Bank has in each assessment area. The Board is considering several approaches to ensure that banks do not ignore smaller assessment areas as a result of this weighting.
- To determine a bank's institution-level CD Test rating, the Board would generate state and multistate Metropolitan Statistical Area (MSA)-level ratings on the test and calculate the weighted average of those ratings.

6 The Board is considering a variety of potential approaches to delineating assessment areas.

The ANPR indicates that the Board is generally considering continuing its current approach of requiring a bank to delineate assessment areas in the geographies surrounding its deposit-taking facilities such as branches, but the Board is considering a number of key changes to the current approach:

- requiring the assessment areas of large banks to encompass whole counties;
- requiring assessment areas to include geographies surrounding a bank's loan production offices (LPOs); and
- permitting banks to exclude their deposit-taking ATMs when delineating their assessment areas.

In addition, the ANPR indicates that the Board is considering requiring or permitting certain banks to adopt so-called "deposit-based" assessment areas in geographies where they take significant amounts of deposits, and/or "lending-based" assessment areas in geographies where they make a significant amount of loans. The OCC's final rule includes the former but not the latter. The ANPR notes that the Board is inclined to include requirements to delineate deposit-based or lending-based assessment areas only for internet banks that do not have physical locations and banks that partner with online lenders that do not have physical loan-making locations. However, the Board is also considering which approaches should apply to hybrid banks that have traditional branch-based assessment areas but conduct a substantial majority of lending and deposit-taking beyond their assessment areas. Additionally, the Board is considering allowing internet banks to adopt nationwide assessment areas.

7 Similar to the OCC, the Board would maintain a qualifying activities list and adopt other procedures to clarify the types of CD activities that receive CRA credit. In some cases, the Board would expand upon the types of activities that count under the CRA compared to its current regulations.

The ANPR indicates that the Board would establish a public, non-exhaustive list of CD activities that receive CRA credit. The Board is also considering adopting procedures that allow stakeholders to request confirmation that a particular activity counts under the CRA. Each would mirror provisions contained in the OCC's final rule.

The ANPR would also change and/or clarify the activities that receive CRA credit. Activities that would receive expanded credit under the ANPR compared to the Board's current rules include those supporting unsubsidized (or "naturally occurring") affordable housing, minority depository institutions (MDIs), women-owned financial institutions, low-income credit unions, and community development financial institutions (CDFIs).

8 Wholesale and limited purpose banks would only be subject to the CD Test, and strategic plans would remain an option for all banks.

Under the ANPR, wholesale and limited purpose banks would be exempt from the Retail Test and instead would be subject only to the CD Test, including a modified version of the CD Financing Subtest. Because the amount of deposits taken by wholesale and limited purpose banks may not reflect their capacity to provide financing, the ANPR indicates that the Board is considering either using these banks' total assets as the denominator of the CD Financing Subtest, or evaluating the amount of their qualifying loans and investments without a deposit or asset denominator. Additionally, the ANPR requests feedback on whether wholesale and limited purpose banks should have the option to be evaluated under a nationwide assessment area.

The ANPR would retain the option for banks to adopt strategic plans and would revise the parameters for strategic plans in certain respects. The Board is considering either requiring or permitting a bank operating under a strategic plan to delineate assessment areas in addition to its branch-based assessment areas that would capture areas in which the bank has a significant proportion of its business and that align with the bank's capacity and constraints, product offerings, and business strategy. The Board is also considering developing an electronic strategic plan template with illustrative instructions to make it more straightforward for banks to engage in the strategic plan request and approval process

9 The ANPR would include accommodations for small banks, but set a lower asset size cap for a bank to be considered small than the OCC has done.

The ANPR would focus the CRA evaluations of small banks on their retail lending activities, with those activities evaluated by default under the qualitative approach used in the Board's current examination procedures for small banks rather than the metrics-based approach of the proposed Retail Lending Subtest. A bank could nevertheless opt into the metrics-based approach. The Board is also considering giving small banks the option to request that retail services, CD activities, or both, be considered as well, without requiring those banks to be evaluated under the formal Retail Services Subtest or the CD Test.

Additionally, a small bank, unlike large banks, generally would not be required to delineate assessment areas that include whole counties, and could exclude parts of a county in which it does not have branches.

The ANPR requests feedback on whether to set the asset threshold differentiating between small and large banks at either $750 million or $1 billion, and whether to adjust the threshold automatically for inflation. This level would not only be substantially lower than the $2.5 billion threshold included in the OCC's final rule, but would also be lower than the $1.305 billion threshold differentiating between intermediate small banks and large banks in the Board's current CRA regulations.

10 Prospects for interagency CRA reform remain uncertain.

Historically, the federal banking agencies almost always have implemented the CRA through identical regulations. The OCC's release of its final rule in May 2020 represented a departure from that coordinated interagency approach. Against that backdrop, the Board's release of the ANPR could shape whether the three federal banking agencies resume work to adopt common standards.

On October 1, 2020, Acting Comptroller of the Currency Brian Brooks reportedly told attendees at a conference that "if [the Board] get[s] good comments in response to their rulemaking, we're not beyond the prospect of finding ways of improving [the OCC's final rule] even more," but cautioned that "in the meantime, I can't sit by another four or five years on my watch and let this thing be the way it was the last 10." The largest OCC-regulated banks will be subject to most of the OCC final rule's requirements beginning January 1, 2023. Meanwhile, key elements of the OCC's final rule – the numerical benchmarks that underpin the rule's various tests – remain unfinalized, and the OCC has indicated that it intends to embark on a separate rulemaking process to establish those benchmarks.

The FDIC had joined the OCC in issuing the December 2019 notice of proposed rulemaking that preceded the OCC's final rule, but it did not join the OCC in finalizing that rule. The FDIC now has several options for how to approach CRA reform, including issuing a final rule similar to the OCC's, joining the Board in a notice of proposed rulemaking, developing its own CRA proposal, retaining its existing CRA regulations, or renewing interagency discussions to adopt common rules.

Whether some or all of the three of the agencies align their approaches could also depend on whether their leadership changes following the November 2020 election.

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