# ABA Bank Compliance

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## Compliance and the Cannabis Conundrum

Risk Assessment

CRA Q&As

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IN JULY 2016, the Federal regulatory agencies issued updates to the Interagency Questions & Answers on Community Reinvestment ("Q&As"). While the Community Reinvestment Act (CRA) and its implementing regulations are fairly short and focused on core requirements, the Q&As are a key guidance document in understanding their real-world application. Tallying over 200 pages, the Q&As outline expanded definitions and examples of how banks can implement programs and services and document community support to ensure positive consideration during their CRA examinations.

A lot has happened in the CRA industry in the two years since the last set of Q&As were issued. The CRA marked its fortieth anniversary. The country experienced historic natural disasters including floods, wildfires, volcanic eruptions and hurricanes, the latter of which prompted new guidance from the Agencies on supporting disaster areas. The changes look to continue as well.

Just this past spring, the U.S. Treasury issued a memo outlining its recommendations for modernization of the CRA, including new thoughts on what should constitute a bank's assessment area and numerous ideas for improving the examination process.

While the CRA industry continues to seek innovative and responsive ways to address the issues communities face around the country, many bankers are still working to ensure that their CRA programs are aligned with the guidance set forth in the 2016 updates to the Q&As. Some banks have already been examined under this new guidance, but many banks have yet to undergo their CRA examination since the publication of these revisions. As a result, this has left uncertainty in how banks should document their performance in relation to these new and expanded guidelines. Banks could even be conducting lending and other




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# FOCUS

# How to Use the CRA Q&As to Support Modern Needs in Communities

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activity that would receive positive CRA consideration during their examination without realizing it.

This article will highlight some of the most interesting Q&As from the 2016 updates and discuss how they can be applied in action to optimize CRA performance—perhaps even utilizing activities your bank is already conducting. Most importantly, this article discusses the ways in which the updates allow banks to support communities with greater flexibility and consideration of our nation's most urgent needs.

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## A Quick Summary of the 2016 Updates

Before we explore some of the Q&As in more depth, a quick look at how the July 2016 updates came about will provide some helpful context. While the CRA was first enacted in 1977, the first Q&A guidance was not published until 1996. Prior to that time, banks seeking answers to their questions about the CRA could discuss questions directly with their federal regulator or review a series of Interpretive Letters published by the Agencies outlining guidance for specific types of investment, lending and service activity. Over the years, the Q&As were periodically updated, with the last significant full publication occurring in 2010, with additional supplemental guidance issued in 2013.

In September 2014, the Agencies proposed new additions as well as revisions to some existing Q&As. This proposal received over 1,000 comment letters that were analyzed by the Agencies prior to issuing the final revised Q&As in July 2016. The final Q&As adopted nine of ten new Q&As proposed in 2014, revised four existing Q&As and adopted two additional new Q&As that were not in the initial 2014 proposal. A total of 25 other technical corrections were also made, such as removing references to the OTS, updating addresses and correcting outdated information. Upon publication in the Federal Register on July 25, 2016, the revised Q&As replaced all other previous versions, including the 2010 full publication and the 2013 supplemental guidance, the majority of which are ultimately incorporated into the new 2016 Q&As.

The revised Q&As focus on a variety of topics of interest for bankers and CRA professionals including lending, qualified investments, community development services and more. However, in this article, the focus is on four Q&As that highlight modern needs in communities and how banks can support those needs as part of their CRA programs, including:

- Investment in community infrastructure as a foundational approach to empower community revitalization (Q&A §__.12(g)(4)(iii)-4);
- Supporting programs that prepare start-ups and small businesses for building bank relationships (Q&A §__.12(g)(3)-1);
- Financing the installation of energy-efficient improvements for affordable housing developers and community nonprofits (Q&A §__.12(g)(h)-1); and
- Exploring new ways of bank products through alternative delivery systems (Q&A §__.12(d)(3)-1).

## Investment in Community Infrastructure

For most of us, it may seem like we are living in the future and it is nearly impossible to keep up with the latest smartphone upgrade or newest mobile app. Disadvantaged communities throughout the country face a more basic technological need—reliable, affordable access to the Internet. This technological disparity, which has generally come to be known as the "digital divide," separates Americans who have easy, reliable access to the Internet and up-to-date computers from those who do not, the majority of which are low-income or located in rural communities.

As Karl Vick points out in his recent *Time* article[1], more than a quarter of Americans do not have access to broadband service, and when you specifically look at households living on under $20,000 a year, less than half of those homes are connected. While it may seem like a first-world problem to lament that not all Americans have a fast Internet connection, the fact that nearly every modern interaction circles back to the Internet raises the stakes. If you want to apply for a job, enroll in classes, check an account balance, sign up for government benefits, your journey often starts and stops with a website.

For years, banks have been charged with understanding their community's needs and taking action to meet them. In regard to low- or moderate-income census tracts, and more recently, distressed and underserved areas, banks have also been asked to focus on activities that revitalize and stabilize these geographies. While these efforts often gravitate to matters of income, employment and housing, it is important to note that investment in infrastructure is also critical to revitalization and stabilization efforts.

In the 2016 Q&As, the federal banking agencies expanded their definition of which type of infrastructure investments will receive positive consideration during CRA examinations. With this update, the agencies explicitly state that bank activities that support "new or rehabilitated communication infrastructure, including broadband Internet services, that serves the community, including low- and moderate-income residents," are viewed as projects that meet essential community needs. This distinction is important, as it allows bank financing or investments for broadband infrastructure to be clearly viewed as community development activities under CRA. By supporting this need, not only can banks receive positive CRA consideration, they can also do their part to bridge the digital divide affecting so many Americans.


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## Preparing Your Bank's Next Business Clients

In a 2017 report, the Small Business Administration highlighted the significant role that small businesses play in our national economy. Throughout the country, there are nearly 30 million small businesses employing almost half of the nation's private workforce. The small business community is both diverse, with over 8 million minority-owned businesses, and ever growing, creating 1.4 million net new jobs in 2014.[2]

As a sub-set of these small business owners, entrepreneurs are individuals who have embarked on the journey to develop their vision into a viable business model. Many individuals who set out on this path to self-employment may not be aware of the financial challenges they will encounter. I experienced this first-hand over five years ago when co-founding findCRA. While I felt my personal financial literacy was above average at the time, making the transition from an established banking career into the world of entrepreneurism opened up a new set of financial demands that required additional education and developing new skills.

Unfortunately, financial illiteracy is often the norm for small businesses. A recent study conducted by Intuit[3] found that more than 40 percent of U.S. small business owners consider themselves financially illiterate. Simultaneously, 81 percent of small business owners handle their own business finances. While banks are seeking opportunities to lend to small businesses as part of their CRA programs, this same study found that 69 percent of small business owners have never taken a loan for business needs.

**It is important that CRA Officers study the full Q&As and take a close look at existing bank initiatives in light of the new guidance.**

Given this data, it may seem difficult for bankers to understand how to best serve the nation's small businesses when they are not seeking loans, which is the primary way for banks to demonstrate small business support during their CRA examinations. Couple this with the fact that a significant portion of small business owners are uncomfortable with their financial knowledge (and are trying to figure it out on their own), and it may seem impossible to find an effective way to work with small businesses.

There is an alternative: the relationship between a bank and a small business, more specifically with an entrepreneur, must start well before the bank is seeking a loan application. This is supported by the most recent Q&As, in which the Agencies point out that economic development activities under CRA include "providing technical assistance to start-ups and recently-formed small businesses, including supportive services such as shared space, technology or administrative assistance." This Q&A not only addresses that this technical assistance will receive positive consideration but clarifies that "technical assistance that readies a business to meet the size eligibility requirements to obtain bank financing will also be viewed favorably."

Understanding that the partnership between banks and small businesses can start much earlier, allows banks to seek opportunities to volunteer with local start-up incubators and small business accelerator programs. This technical assistance, whether in the form of one-on-one mentoring to entrepreneurs or financial training to groups of small business owners, can create long-lasting business relationships for banks, with the added benefit of earning positive CRA consideration during examinations.

## Embracing Energy Efficiency in Affordable Housing

When thinking of energy efficiency and housing, the first thing that springs to mind may be your independently-wealthy neighbor who just paid to have solar panels and geo-thermal heating installed at his home. Luckily, energy efficiency is no longer a benefit reserved for those with disposable income.

A movement has begun throughout the nation to incorporate energy-efficient standards into affordable and low-income housing in many communities. In recent years, the EPA published a study[4] exploring energy efficiency in affordable housing, highlighting the fact that energy costs contribute substantially to the overall financial burden of a household. Federal, state and local governments continue to explore ways to incorporate energy-efficient improvements in new and existing housing developments in cities and neighborhoods of all sizes.

This focus on energy efficiency supports the expanded guidance provided by the Agencies in the new Q&As. The Agencies clarify that banks can receive positive CRA consideration for "community development loans made to affordable housing developments or community facilities that serve low- and moderate-income individuals." These improvements can include "renewable energy, energy-efficiency initiatives or water conservation projects for single-family housing, multi-family housing and community facilities including measures to reduce energy costs" for tenants and common areas. Banks that provide loans for such purposes should include them as part of their eligible CRA activities.

One such example of how this activity has been deployed in action is the SmartMH program, launched in Kentucky and offered by the Next Step Network. This program has created an innovative way to support energy efficiency in affordable manufactured housing through collaborative partnership. By working with local utilities, manufactured housing builders, lenders, retailers and other industry players, Next Step has created a program that empowers homebuyers to purchase an energy-efficient manufactured home. These homes provide instant financial benefits through reduced energy costs, sometimes totaling hundreds of dollars a month. This program was so groundbreaking, Freddie Mac recently partnered with Next Step Network and eHome America to expand the program to new states.

## Exploring Alternative Delivery Systems

As any CRA Officer knows, for many years the primary "alternative delivery system" outlined in the Q&As was ATMs, a service that first launched in 1969. With the 2016 revisions to the Q&As, the examples of alternative delivery systems have expanded to include online banking and mobile banking. While this is an important step forward in CRA guidance, data shows that most consumers view both online banking and mobile banking as core delivery services for banks in 2018. Including them only makes sense, but it fails to look far enough into the future of banking alternatives.[5]

In a recent survey[6], the American Bankers Association found that Millennials are three times more likely to open a bank account with their phone than in-person. This age group also wholeheartedly believes that within the next few years, the way that we access money will be completely different. In a similar survey[7], a majority of Baby Boomers stated that they access online banking weekly and 23 percent of this generation uses their smartphones for banking.

Since most consumers are banking from their phones, what emerging opportunities do banks have to provide more progressive alternative delivery channels for bank services and loans? The need to explore alternatives comes as competition increases from established alternative financial service providers like PayPal, and new entrants like Amazon. Mostly due to mergers and acquisitions the number of banks in the nation has continued to shrink, while the need for financial service providers has grown. These new non-bank players create an expanding landscape of options for both consumers and banks to explore.

The rise of fintech companies has seen success in reaching a core group that CRA professionals work to support the unbanked and underbanked. For example, Credit Karma provides free credit scores and guidance on selecting the right loan options. Companies like Kabbage, Kiva, Prosper and Lending Club are providing alternative solutions for small dollar and small business loan needs, allowing consumers to bypass some of the more traditional barriers to credit. Fintech companies like Beam and SoFi offer deposit product alternatives, and there are many prepaid card options available to consumers.

It is important that banks look to these market innovators and incorporate similar strategies to meet consumers where they want to bank, which in most cases is wherever they can find a reliable WiFi connection. Thinking about the crossroads of CRA and fintech, banks can leverage alternative delivery systems like mobile banking as a tool to educate consumers about financial literacy concepts or proactively reach into communities where it may not be feasible to place a brick-and-mortar branch or even an ATM.

In recent years, numerous tools have emerged that allow bankers to deploy financial literacy solutions online and through smart phone apps. By white labeling these solutions and offering them either independently or through mobile banking integrations, bankers can provide important services to individuals throughout their communities. Similarly, looking to some successful fintech offerings like small dollar loan programs, microbusiness loans or peer-to-peer lending platforms, banks can deploy innovative lending solutions to meet the needs of underserved communities. As a result, these communities can avoid predatory lending alternatives.

## Other Areas to Explore

The 2016 revisions to the Q&As include many additional areas for bankers to understand as they work on their CRA strategy. Some other important takeaways include guidance on workforce development initiatives for low- and moderate-income job creation, utilizing alternative credit histories in loan underwriting and considerations for small dollar loan programs. The Q&As also provide additional information on innovative and responsive actions that banks can take and how to document these efforts for their CRA examination.

**Until we see a final rule, the Q&As outline many important considerations for bankers as they serve their assessment areas.**

It is important that CRA Officers study the full Q&As and take a close look at existing bank initiatives in light of the new guidance. There may be activities that a banker has previously ruled out as not eligible for CRA that are now in line with the updated guidance and will receive positive CRA consideration during the bank's next examination.

In the coming months, additional proposed changes to the CRA are expected, including amendments from the Agencies to the implementing regulations. It remains to be seen what these changes will encompass and how they will incorporate the recent Treasury recommendations and other emerging industry trends. Until we see a final rule, the Q&As outline many important considerations for bankers as they serve their assessment areas. Time spent understanding these Q&As and more importantly, finding ways to bring them to life in a bank's communities, could not only benefit the bank's overall CRA rating, but will also support the spirit of community reinvestment. ■

## ABOUT THE AUTHOR

**BRIAN WATERS, CRCM**, is the President and Co-Founder of findCRA, which develops and deploys groundbreaking tools to streamline research and empower partnerships between banks and nonprofits nationally to optimize CRA outcomes. He has nearly 20 years experience in banking compliance and community development and is a resident of Louisville, KY. Connect with him at brian@findCRA.com.

## Endnotes


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