CRA Modernization Is Here… NOW WHAT?

Diving into the significant changes to qualifying bank activities under the new CRA final rule.

BY BRIAN WATERS, CRCM

NEW RULES TO MODERNIZE the Community Reinvestment Act (CRA) are finally here….at least for banks regulated by the Office of the Comptroller of the Currency (OCC). The last time CRA regulations were substantively updated was in 1995, when banks still relied primarily on their network of branches to deliver products and the Internet was simply a novel hobby for a few early adopters.

The new OCC final rule, published in the Federal Register on June 5, 2020, culminates a multi-year regulatory undertaking to update bank requirements and the CRA examination process to address changes in the way that consumers interact with banks, how banks deliver their services, and the evolving needs of communities throughout the country. Unlike prior CRA reforms, this final rule is a solo effort by the OCC to require its banks to adopt a new standard, separate from the Federal Deposit Insurance Corporation (FDIC) and Federal Reserve Board's CRA requirements.

The changes are expansive, impacting every part of CRA management for banks, including which activities qualify, recordkeeping, reporting, and the examinations. In this article, the first in a two-part series concluding in the next issue, we'll explore the OCC's new requirements for which activities will qualify as community development under the new final rule, which activities will no longer qualify, and new requirements for banks to calculate activity values to report during their examination.

The Path to CRA Modernization

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Since 1995, several attempts have been made to update the implementing regulations of CRA. Most recently, in April 2018, the U.S. Treasury published a memo outlining its recommendations on how the CRA requirements could be modified to better suit today's current banking industry. The Treasury's memo acknowledged needed reforms in how banks delineate their CRA assessment areas, which are currently the communities where banks have a main office, branch, deposit-taking ATM, or a substantial portion of lending activities. The majority of the Treasury's memo called for significant reform to the examination process itself, calling for increased clarity and flexibility, improved examination timeliness and accountability, and better incentives for banks to serve the intended purpose of the CRA.

Shortly after the issuance of the Treasury's memo, the OCC stepped out alone to issue an Advance Notice of Proposed Rulemaking (ANPR) in August 2018. This move surprised most CRA professionals as, historically, the three regulatory agencies have acted in unison when issuing any interpretative or regulatory guidance related to CRA and most other major rulemaking areas. The OCC sought input from stakeholders about CRA exams, community development activities, and more, planning to utilize the responses provided to craft its proposed rule.

Over the next several months, discussion around CRA modernization continued, with the FDIC joining the OCC to issue a proposed rule on December 12, 2019. Throughout this process, the Federal Reserve Board has remained outside of the discussion, with Gov. Brainard reaffirming the need to stay true to the core purpose of CRA when considering any modernization updates. Comments to the proposed rule were originally accepted through early March 2020, allowing only 60 days for the banking industry to digest and coordinate replies to an ANPR that clocked in at almost 250 pages. This initial comment period was later extended through April 8th after Congress pushed for more time. In the midst of the comment period, the world screeched to a halt under restrictions related to the COVID-19 pandemic.

While most bankers worked from home and the nation's unemployment rose to over 20 percent, the OCC moved forward with issuing its final rule to modernize CRA. The agency stated that it had received over 7,500 comments to the proposed rule

and had carefully considered each comment during the 30 working days that occurred between the end of the comment period and the release of the draft final rule on May 20, 2020. Shockingly, the FDIC dropped out from jointly issuing the final rule with the OCC, with Chairman McWilliams noting in an official statement on May 20th that, "The FDIC recognizes the herculean effort community banks are making to support America's small businesses and families during this challenging time and encourages financial institutions to work constructively with borrowers affected by COVID-19." Comptroller of the Currency Joseph Otting announced the following day that he was stepping down from his post, effective May 29th.

Implementation of the Final Rule

The final rule is effective on October 1, 2020 for all OCC-regulated banks. However, most sections do not require mandatory compliance on that date. The rule provides for a multi-year transition period through January 1, 2024.

Key to the implementation is determining which asset or operational classification a bank receives under the new rule. The final rule preserves many of the CRA bank classifications. Banks that are operating as a wholesale or limited purpose bank or under an approved strategic plan will continue do so in the future, at their choice. Small banks will continue to be examined under current small bank examination procedures, for the most part, but the asset size test for small banks has been increased to include banks with $600 million in total assets in four of the five prior calendar quarters. Similarly, intermediate small banks have been renamed the simpler "intermediate bank" and are institutions with up to $2.5 billion in total assets in four of the five prior calendar quarters. Intermediate banks will continue to be examined under existing intermediate small bank requirements. Large banks—those with over $2.5 billion in assets—will be examined under new general performance standards, which we will discuss in the second article in this series.

The Move Away from the "Four Pillars of CRA"

As part of the final rule, the OCC has moved away from the traditional "four pillars of CRA" including affordable housing, economic development, community services to low- and moderate-income individuals, and revitalization or stabilization activities —the activity categories that have been recognized as the key tenets of community development for decades. The OCC reordered the activity qualifications to address uncertainty for banks about whether a particular activity qualifies for CRA consideration during an examination and to eliminate opacity and inconsistency in which activities qualify between banks, regions, or, in some cases, CRA examinations at the same bank.

In place of these four pillars, the OCC has developed a much larger list of qualifying activity criteria, incorporating most of the activities currently grouped into the four pillars, either wholesale or reorganized into a new criterion. While many banks will continue to be examined under existing OCC procedures rather than the new general performance standards, it is important to note that the OCC's new methodology and requirements for activity qualification applies to *all* national banks regardless of their asset size designation or classification.

Under the final rule, a "qualifying activity" for CRA is defined as "an activity that helps meet the credit needs of a bank's community, including low- and moderate-income individuals and communities…" The rule applies a broad interpretation of providing financing and support for the community that includes all lending, investment, and service activities that a bank undertakes that also meet the qualifying activities criteria. As part of the final rule, the OCC has eliminated the common term "qualified investment" and replaced it with "CD investment."

The majority of activities that a bank has traditionally undertaken to support community development continue to qualify under the new rule. The focus of the activities remains on supporting low- and moderate-income (LMI) individuals,

low- and moderate-income census tracts, small businesses, small farms, and other geographic areas with designated needs, such as distressed and underserved census tracts.

Determining What Qualifies Under the New Final Rule

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Lending Activities

The agency has expanded which types of loans will be reviewed and evaluated for CRA consideration. The final rule represents a major shift, moving the focus of lending analysis *away* from Home Mortgage Disclosure Act (HMDA) to loans reported on the bank's quarterly Call Report. By moving to the Call Report, the OCC is able to obtain more frequent updates on bank lending activity.

Going forward, when assessing a bank's lending, the OCC will continue to review home mortgage loans to LMI individuals and small loans made to businesses and farms in LMI census tracts. Lending evaluations will also continue to include loans made to "CRA-eligible businesses" and "CRA-eligible farms," which are new terms that officially replace the historical "small business" and "small farm" definitions under CRA.

Not only has the terminology changed regarding "CRA-eligible businesses" and "CRA-eligible farms," but the thresholds for designating businesses and farms as

such has also been updated. In order to be considered a CRA-eligible business or CRA-eligible farm, the gross annual revenue threshold has increased to $1.6 million and will be adjusted every five years for inflation. The threshold for a small loan to a business or a farm has also been increased to $1.6 million.

In addition to these historical types of loans reviewed during CRA examinations, the lending test will also include new types of lending activity. Under the final rule, loans made in geographies officially designated as "Indian country" or other designated tribal and native lands will be reviewed. Also, consumer loans made by the bank will be evaluated as part of the lending analysis, including revolving credit plans, automobile loans, low-cost education loans, and other consumer loans, but excluding credit cards and overdraft programs.

Supporting Geographies of Need and CRA Deserts

The OCC's final rule places a significant focus on qualifying activities that support "Indian country" and other geographies of need, including expanding the types of census tracts that can be designated as distressed or underserved.

Regarding "Indian country," the OCC is focused on bank delivery of qualified loans, investments, and services targeted to homeowners, individuals, businesses, farms, or organizations operating in these geographies. The OCC has defined "Indian country" (as outlined in 18 USC 1151) to include all lands within the limits of an Indian reservation, all dependent Indian communities, and all Indian allotments within the borders of the United States or its territories. In response to comments received on the proposed rule, the final rule expands the definition of "Indian country" to include other native and tribal lands throughout the nation. This expansion now incorporates census tracts defined by the Census Bureau as tribal, Alaskan native, or American Indian joint-use. It also includes Hawaiian home lands and state-designated tribal statistical areas.

As part of the final rule, the OCC has expanded the types of census tracts that can be designated as distressed or underserved. In the past, only *non-metropolitan*

census tracts could receive such a designation, but now, *any* census tract can be designated as "distressed," including those in *metropolitan* areas, due to poverty, unemployment, or population loss. Also, census tracts can now be designated as "underserved" when they are determined to be banking deserts, based on the location of the nearest branch to the center of a census tract or the absence of a bank branch in a census tract altogether.

In the final rule, the OCC also introduces a new process whereby a geographic area can also be confirmed as a "CRA desert" by the agency. In order to be considered a CRA desert, the geography must have significant unmet community development or retail lending needs. These needs can be evidenced by either few banks with branches or non-bank depository facilities in the area; less retail or community development lending than would be expected based on demographic or other factors for the area; or a lack of community development organizations and infrastructure. Only the OCC can designate an area as an official CRA desert through on online submission process. Once designated as a CRA desert, a geography will be maintained on a list of all CRA deserts on the OCC's website.

The New Criteria for Qualifying Activities

In place of the four pillars of CRA community development, the OCC has outlined a longer list of qualifying activity criteria for banks to utilize in determining if a loan, investment, or service should be considered qualified. This list of qualified activities includes:

- Affordable housing provided to LMI individuals or in "Indian country," including "naturally occurring affordable housing" created without any subsidies and activities that finance or support owner-occupied housing purchases, refinances, or improvements for LMI families, other than direct purchases (think, for example, about activities supporting a nonprofit that will build homes that will later be owner-occupied by a LMI family).
- Community support services including childcare, education, health services,

workforce development, and job training that serves LMI individuals or families.

- Economic development activities including job creation and retention for LMI individuals; technical assistance and supportive services to small businesses; government programs supporting small businesses or farms; support for Small Business Development Companies, New Venture Capital companies, Community Development Entities, and Rural Business Investment Companies; and activities that retain existing or attract new businesses, farms, or residents to LMI census tracts or other designated geographies of need.
- Essential infrastructure such as roads, telecommunications, broadband service, mass transit, water systems, industrial parks, and more that partially or primarily benefit LMI individuals, LMI areas, or other designated geographies of need.
- Essential community facilities including schools, libraries, parks, hospitals, health care facilities, and public safety facilities partially or primarily benefitting LMI individuals, LMI areas, or other designated geographies of need.
- Activities that support athletic facilities, including sports stadiums, that increase opportunities for economically disadvantaged individuals and areas.
- Supporting family farms, not just with lending, but through other activities including purchases or leases of farm land or equipment; technical assistance and supportive services; and activities that support the sale or trade of the family farm's own production.
- Government programs, projects, or initiatives offered by federal, state, local, or tribal governments that serve LMI individuals or help with revitalization, stabilization, or recovery efforts in LMI census tracts, distressed areas, underserved areas, disaster areas, or "Indian country."
- Financial literacy programs including financial education and homebuyer counseling to any individuals *regardless* of their income level.
- Investments made into qualified funds benefitting designated Opportunity Zones that are also LMI census tracts.

- Capital investments and loan participations in minority depository institutions, women's depository institutions, Community Development Financial Institutions (CDFIs), and low-income credit unions.
- Activities that support another bank's community development lending, investments, or services.

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Another major change is the OCC's methodology for assessing CRA activity value, which includes a shift from only considering activities as CRA-qualified when the *majority* of the activity benefits a LMI individual, LMI census tract, or other designated geography of need. Under the final rule, banks will now be able to receive *pro rata* credit for activities that only *partially* benefit LMI individuals or CRA geographies. For example, if a bank makes a loan or investment to a nonprofit that only serves 30 percent LMI individuals under the current rule, it would not be qualified as a CRA activity. Under the new rule, the bank can receive credit for 30 percent of the value of the activity during CRA evaluations, but the burden of proof is on the bank to determine and document the partial benefit.

What Didn't Make the Cut?

Several activities and requirements that are part of the current CRA process did not make it into the new final rule:

- The terminology of "revitalization and stabilization" appears in some of the new qualifying activity criteria, such as economic development, but an activity

will no longer be qualified outright as "revitalization and stabilization" going forward—that pillar no longer exists.

- Also gone is the concept of a "service test" as part of the CRA examination process for large banks. We look at the new examination requirements in the next article in this series, but banks evaluated under the new general performance standards will need to accumulate the number of hours of volunteer service conducted in qualified activities and report that service based on an equivalent dollar value of a flat hourly wage for each employee. Rather than having to determine the actual hourly wage for each employee, the OCC has stipulated that a flat hourly wage based on the median hourly compensation for *the bank industry* will be used based on aggregate Call Report data.
- In other aspects of service, also gone is the requirement for bank service hours to be related to "technical assistance" or "financial expertise" provided by the bank employee. With the new rule, *any* service provided under a qualified activity now counts, including manual labor. Also, the requirement that financial literacy be targeted to primarily LMI individuals has been eliminated, allowing banks to receive credit for all financial literacy, financial education, and homebuyer counseling activities, regardless of the recipient's income level.
- Finally, banks will no longer have the option to submit activities conducted by bank affiliates for CRA evaluation. While the proposed rule sought to mandate that *all* affiliate activity would have to be considered as part of a bank's CRA evaluation, the final rule went in the opposite direction and now mandates that *none* of a bank's affiliate activities can be included.

New Qualifying Activities List

To assist banks with determining which activities will count going forward and under which criterion an activity should be placed, the OCC has established a new list of qualifying activities. This list includes a non-comprehensive, illustrative compiling of examples of activities that will qualify and will be posted on the OCC's website. The

list should be used by banks (and examiners) as a guideline and does not prevent banks from submitting other activities that are not included on the list for CRA evaluation, as long as the activity's community development qualification can be documented and supported.

Bankers or any other interested party will have the ability to submit activities to the OCC for determination of their qualification and possible inclusion on future updates to the list of activities. This process will utilize an online form hosted on the OCC's website and is still in development. The OCC will provide its determination within 90 days after the request is submitted. The OCC will also update the list annually and, every three years, revise the list through the public notice and comment process.

Assigning a Monetary Value to CRA Activities

Under the final rule, the OCC is focused on ongoing, long-term commitment as reflected by the bank's balance sheet. As such, the final rule will assess the CRA value of qualified activities based on the average month-end outstanding amount of each loan or investment on the bank's balance sheet. Credit for monetary donations, in-kind donations, and service hours will be given based on their value when they occurred. The OCC believes this new approach will eliminate the apparent inflation of CRA activities that occurs when banks purchase loans or investments just prior to a CRA examination and then sell those loans or investments immediately after the examination is complete.

The OCC has created a tiered approach to calculating the value of activities, based on the type of activity and including multipliers for certain activities. Qualified loans, including commitments to lend, and investments are assigned a value based on their average month-end on-balance sheet amount. Any retail loans sold by the bank within 365 days of loan origination are valued at 100 percent of their origination amount. Monetary donations are counted at the face value of the donation and in-kind donations are attributed the fair market value of the in-kind items donated. As

discussed above, qualified service hours are assigned a value based on a flat hourly wage for the banking industry and affiliate activities receive no value.

After conducting the initial value determination of all qualified activities, banks may also be eligible for multipliers for certain activities. In order to be eligible for multipliers, the bank must first achieve an approximately equal amount in the quantified dollar value of qualified activities in the current evaluation period as reported in their prior evaluation period. If a bank achieves this threshold, then the bank will receive a *two-times* multiplier for the following activities:

- Community development loans, investments, and services undertaken with CDFIs, excluding mortgage-backed securities;
- All other community development investments, excluding mortgage-backed securities and municipal bonds;
- All other affordable housing related community development loans;
- Retail loans generated by branches located in LMI census tracts;
- All other community development services;
- Qualifying activities with minority depository institutions, women's depository institutions, and low-income credit unions; and
- Qualifying activities in CRA deserts confirmed by the OCC.

The OCC also has the ability to apply a *four-times* multiplier when conducting the bank's CRA evaluation for any activities that it deems to be responsive, innovative, or complex.

What's Next

While the process for determining which activities qualify under CRA as part of the new OCC final rule may seem complex, generally, most of the activities that a bank

has participated in to support community development in the past will still qualify. The transition period for the new rule extends into 2024 and the OCC plans to continue to issue examiner and interpretive guidance between now and that date.

With the October 1, 2020 deadline looming, it is important to note that banks will not immediately have to be in full compliance with all aspects of the new rule on that date. While the banking industry works to understand and begin implementation of the new rule, a battle has begun to stop the new rule from ever taking effect. On June 25, 2020, the National Community Reinvestment Coalition and California Reinvestment Coalition jointly filed a lawsuit against the OCC in the U.S. District Court for the Northern District of California alleging that the final rule unlawfully eviscerates anti-redlining rules. Just days later, Congresswoman Maxine Waters and Congressman Gregory Meeks brought House Joint Resolution 90 to Congress as a resolution of disapproval of the OCC's rule, seeking to nullify the final rule completely. The Resolution passed the House on June 29, 2020.

For now, the final rule stands, and each bank must determine its impacts on day-to-day operations and risk management. Our second article in this series will cover more about the transition period, new assessment area requirements, and the general performance standards for bank examination in the next issue.

ABOUT THE AUTHOR

BRIAN WATERS, CRCM, is the President and Co-Founder of findCRA, which offers online services for banks to identify and document CRA-qualified nonprofit relationships and build instant performance context, as well as, traditional CRA consulting and training services. He has 20 years of experience in banking compliance and community development and is a resident of Louisville, KY. Contact him at **brian@findCRA.com**.

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