The Modern CRA Examination Playbook

Exploring the evolving process for CRA examinations under the OCC's final rule

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BEGINNING OCTOBER 1, 2020, the rules of the Community Reinvestment

B Act (CRA) changed for banks regulated by the Office of the Comptroller of the Currency (OCC). On that date, the OCC's final rule became effective for the agency's plan to modernize the CRA. With the rule change, all CRA professionals, from the most experienced CRA Officer to the newest staff member, were propelled into a different way of playing the CRA game with a new playbook. While the first OCC examinations under the new rules aren't for several years, it is never too early to start preparing.

In my first article, CRA Modernization is Here, Now What?, in the September–October issue, I explored the regulatory timeline and path that led to the OCC's new CRA modernization rule. I also discussed the major changes to which OCC -regulated bank activities will qualify for CRA consideration, including a new list of OCC-approved CRA activities, and the requirement for banks to value all CRA-qualified activities under a new methodology. That information provides the necessary context to understand the shift in how CRA examinations will change in the future for OCC-regulated banks. In this article, I will discuss new requirements for how banks must delineate their assessment areas and how the OCC will conduct CRA examinations for national banks of all asset sizes.

Assessment Areas

Under the CRA, banks are required to define their assessment areas as the geographic areas where they can reasonably be expected to serve. Since the foundation of CRA is rooted in the need to prevent redlining, it only makes sense that determining the markets a bank serves is a key factor during CRA performance evaluations. CRA examiners evaluate lending both inside and outside of a bank's assessment areas, with banks often receiving criticism if too many loans are originated or purchased outside of these areas. Examiners also evaluate the bank's record of lending to low- and moderate-income individuals, small businesses, and small farms in a bank's assessment area, as well as the bank's track record of community development investment and services. Banks are only able to receive credit for CRA activities conducted outside of their assessment areas if they have successfully responded to the needs within their assessment areas first.

Historically, assessment areas have been defined by the location where banks have a physical presence or where the bank has a substantial portion of its lending. Under the existing CRA, this includes the bank's main office location, branches, and deposit-taking ATMs. To ensure that banks are not strategically choosing to exclude placing branches in certain areas that are strong sources of loans for the bank, assessment areas must also include any surrounding geographies where the bank originates or purchases a substantial portion of its loans. These historical assessment areas were allowed to be delineated by certain geographic boundaries, such as a Metropolitan Statistical Area (MSA) or a county. However, they could also be carved out as smaller portions of a county as long as the bank did not arbitrarily exclude low- and moderate-income areas or census tracts.

The historical concept of assessment areas is mostly maintained within the new OCC final rule and rebranded as "facility-based assessment areas." Recognizing the importance of bank branches to serving low- and moderate-income communities, the OCC wanted to reaffirm their commitment to ensure that banks would maintain a physical presence in those communities. Banks will be expected to delineate facility-based assessment areas in the same way as before; however, the new rule now stipulates that the smallest geography a bank can select for an assessment area is a whole county or county equivalent. Banks can no longer take only a portion of a county as a facility-based assessment area.

The OCC final rule also introduces a new, second type of assessment area–the "deposit-based assessment area." The OCC pointed out that some banks have implemented business models whereby they are soliciting deposits from a much larger, sometimes national, geographic footprint than their facility locations. In those instances, the OCC believes that it is important that banks which are accepting a significant portion of their deposits from outside of their facility-based assessment areas should also be evaluated for CRA performance in the new deposit-based assessment areas.

Going forward, banks that receive more than 50 percent of their retail domestic deposits from geographies outside of their facility-based assessment areas must also delineate new deposit-based assessment areas. The two types of assessment areas cannot overlap, and a bank must delineate a deposit-based assessment area for any geographic area where it receives five percent or more of its retail domestic deposits. These deposit-based assessment areas could be comprised of:

- A whole state;
- A whole MSA;
- A whole nonmetropolitan area within a state;
- One or more contiguous metropolitan divisions;
- One or more contiguous counties or county equivalents; or the
- Remaining geographic area of one of the prior areas excluding facility-based assessment areas.

Small and Intermediate Bank Examinations

Under the OCC's final rule, the bank asset size designations for bank examination requirements remain. Small banks are now defined as institutions with assets of $600 million or less in four of the previous five calendar quarters. Intermediate banks, formerly known as "Intermediate Small" banks, are now defined as institutions with assets that exceed the Small bank threshold but with assets of $2.5 billion or less in four of the previous five calendar quarters. In both cases, the asset size threshold has nearly doubled from the prior rule and will be adjusted annually by the OCC.

The good news is that, for the most part, the OCC's new CRA examination process for Small and Intermediate banks will remain the same as before. The new rule provides for a transition period for its various requirements, allowing Small and Intermediate banks to rely on the "old" examination rules through January 1, 2024.

However, Small and Intermediate banks will need to comply with new OCC requirements for CRA activities qualification as outlined in my previous article, in the September–October issue, page 22.

As a side note, Wholesale and Limited Purpose banks will also continue to be designated as such under the new rule and will follow substantially the same examination process as before. Also, banks operating under a Strategic Plan will be evaluated under the requirements for strategic plan banks.

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General Performance Standards

The most substantive changes to the examination process come about in the introduction of new general performance standards for banks that are not designated as Small, Intermediate, Wholesale, Limited Purpose, or Strategic Plan banks under the new rule. Small and Intermediate banks can choose to be evaluated under these new general performance standards, but for larger banks without a special designation, these new standards are required.

The new general performance standards consist of two key components:

1. An evaluation of the distribution of the bank's retail loans to low- and moderate-income individuals, CRA-eligible businesses and farms, and in low- and moderate-income geographies; and
2. The impact of the bank's CRA qualifying activities measured relative to the

bank's retail domestic deposits.

Banks will be required to conduct their own CRA evaluation to assess performance relative to these two standards, prior to the OCC CRA examination and determine presumptive ratings based on the new evaluation criteria outlined in the final rule. These *presumptive ratings* will be determined at both the bank and assessment area levels and will be validated by the OCC examiners during the bank's scheduled CRA examination. In order to ensure consistency in the application of the new general performance standards, the OCC has developed standardized evaluation measures for banks. The standards for calculating the value of each CRA activity conducted by banks were discussed in our last article.

Banks are required to complete CRA evaluation measures annually. The annual measurement quantifies the level of activity and will be part of the CRA performance evaluation. Under the OCC's final rule, a bank's CRA evaluation measure is calculated as the sum of the bank's annual qualifying activities divided by the average quarterly value of the bank's retail domestic deposits at the close of business on the last day of each quarter for the same period. In addition to that calculation, the bank must add the number of the bank's branches located in or serving low- and moderate-income census tracts, distressed areas, underserved areas, or Indian Country divided by the total number of bank branches during the same period multiplied by .02. Simple, right?

Retail Lending Distribution Test

To garner a qualitative view, OCC-regulated banks will also be evaluated under the retail lending distribution test. This test is similar to how banks are currently evaluated under the lending test during CRA examinations. This retail lending distribution test will now utilize Call Report data and will evaluate the bank's major retail lending product lines with twenty or more originations per year in the assessment area.

Geographic Distribution Test

To determine the sufficiency of the retail lending distribution, the geographic distribution test will evaluate the bank's record of lending in low- and moderate-income census tracts in its assessments areas, and results will be compared to the assessment area demographics and peer comparators.

Borrower Distribution Test

The borrower distribution test will evaluate the bank's record of lending to low- and moderate-income individuals or families or CRA-eligible businesses and farms in its assessment areas, again in comparison to demographic *and* peer comparators. In both tests, product lines could include home mortgage loans, small business loans, and/or small farm loans.

CRA Ratings

The OCC will assign banks one of the four CRA ratings upon completion of the CRA examination by the OCC. Both the bank and examiners will take into consideration applicable performance context as part of the CRA evaluation. Banks receiving an "Outstanding" rating will be included on a list published on the OCC's website and will receive an OCC seal for marketing and promotional purposes. The new rule provides for a transition period to its various requirements, allowing banks that will be evaluated under the general performance standards to rely on the "old" examination rules through January 2023.

One important piece of the evaluation puzzle that is missing from the OCC final rule is the methodology and requirements for standardized benchmarks and thresholds for evaluating CRA activity across all institutions. While the OCC's proposal included detailed information about how it planned to implement these new benchmarks, including proposed levels of performance, they were excluded entirely from the final rule.

The OCC stated in the commentary to the final rule, that upon further review, the agency noted that it did not have sufficient data to detail new methodologies for benchmarking. The agency deferred finalizing this aspect of the rule to further assess available information relied upon to establish benchmarking methodologies and standards. In addition, the OCC said they have plans to issue a new, separate Advanced Notice of Proposed Rulemaking (ANPR) at a future date to establish these standards. In the interim, it remains clear that comparative analysis remains a critical component of the CRA performance evaluation process. The analysis helps provide banks a sense of how they the fare among other banks (before exams) and will provide perspective going forward when evaluated under the framework of the OCC rule.

Recordkeeping and Reporting

Another major requirement under the new OCC final rule is the expanded recordkeeping and reporting requirements for banks, especially those that will be evaluated under the general performance standards. Of note, the OCC has shifted primarily to utilizing Call Report data for CRA lending evaluation, thereby breaking the link between HMDA data and CRA performance. However, HMDA data will still be utilized as a primary evaluation component in fair lending testing and must be reported with the same accuracy and validity as it has in the past to avoid examiner criticism and civil money penalties.

Under the new OCC rule, banks that will be evaluated under the new general performance standards will have to collect, maintain, and report a long list of data including qualifying activities, certain non-qualifying activities, retail domestic deposits, assessment area composition, and more. This data collection includes information the bank utilizes to calculate its presumptive ratings and the data will be validated by the OCC prior to the bank's CRA examination.

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In addition to the detailed records on how the bank calculated its presumptive ratings and CRA qualifying activities, the bank will also need to maintain and report dozens of additional pieces of information about qualifying loans, community development investments, community development services, retail domestic depositor location data, non-qualifying loan activities, and more. All data must be kept in a standardized, machine-readable format that will be outlined by the OCC and reported by the bank annually in a new prescribed process. Data records would have to be maintained by the bank through its CRA examination.

For Small and Intermediate banks, a much shorter list of data will need to be collected and maintained by the bank, including data on retail domestic deposits and assessment area delineation, for example. However, this data does not have to be reported annually and would need to be available for review at the bank's scheduled CRA examinations.

The prescribed and standardized formats for the data collection, recordkeeping, and reporting are still being developed and banks will not have to comply with these requirements for several years. The OCC did note that it expects that banks will utilize vendor solutions to meet some, if not all, of these needs in the future.

As with any new rule, implementation often takes longer than planned. While the OCC's final rule attempts to address many of the concerns and criticisms noted by the industry and the U.S. Treasury in its April 2018 memo, the execution of CRA modernization continues to evolve. Many components of the new rule are still being developed in practice, with additional requirements yet to be formed. The OCC has stated that new guidance and interpretive documents will be issued over the next few years as banks work to implement the final rule. Stay tuned…

ABA RESOURCES:

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Access all ABA resources on Community Reinvestment Act modernization, including regulatory releases, comment letters, webinars and Newsbytes stories at **aba.com/CRAModernization**.

ABOUT THE AUTHOR

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