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Tips for a Successful Transition to an Intermediate Small Bank

IT'S FINALLY HAPPENED. While on one hand you're excited that your bank has continued to grow, you're also wondering what it means now that you've crossed the threshold to becoming an Intermediate Small Bank under the Community Reinvestment Act (CRA). As the bank's CRA Officer, you're now faced with new regulatory requirements and expanded documentation to evidence how your bank helps through community development efforts. What exactly does it mean to be an Intermediate Small Bank and how will you have to adjust your CRA program to meet these new requirements?

Your New CRA Identity

As outlined in the implementing regulations to the CRA, the banking agencies have created several CRA designations for banks. A few banks operate under a CRA Strategic Plan and others are designated as Limited Purpose or Wholesale Banks based on their business model. However, the majority of banks operating in the nation are assigned one of three CRA asset size designations—Small, Intermediate Small, or Large.

While Large Banks are often the focus of CRA commentary, receiving the most attention during CRA examinations and in industry analysis, of the nearly 5,000 banks chartered in the United States, fewer than 750 (approximately 15%) are designated as a Large Bank under CRA. On the other end of the size spectrum, over 50% of banks are designated as a Small Bank. Right in the middle sits the Intermediate Small Bank.

To be designated as an Intermediate Small Bank, a bank must meet a technical definition outlined in the CRA regulation. As of January 1, 2022, an "Intermediate Small Bank" is any bank that has less than \$1.384 billion in assets as of December 31st in each of the prior two calendar years, but also had assets of at least \$346 million in either of the prior two calendar years. In other words, if your bank's assets were under \$1.384 billion in the past two years, but exceeded \$346 million in either year, you're now

an Intermediate Small Bank. These asset thresholds are adjusted each calendar year by the banking agencies.

Over the past year, CRA modernization discussions have introduced the possibility of new thresholds for Intermediate Small Banks. In the OCC's final 2020 CRA rule, the agency stipulated that a Small Bank would be any bank with \$600 million or less in four of the five previous calendar quarters and similarly an Intermediate Bank would be any bank with \$2.5 billion in assets during the same time period. However, in December 2021, the OCC officially rescinded its 2020 final rule and has reverted back to the historical regulatory requirements for determine bank CRA designations by asset size effective January 1, 2022. It remains to be seen where this discussion will next lead during the ongoing CRA modernization efforts by the banking agencies.

Impacts on Loan Tracking & Reporting

The good news is that when your bank becomes an Intermediate Small Bank under CRA, not much changes for your required regulatory reporting of certain types of loans. If your bank is already a required reporter under the Home Mortgage Disclosure Act (HMDA), you will continue to follow the same guidance for reporting mortgage loans. If you are not already a HMDA reporter,

becoming an Intermediate Small Bank does not require you to now report mortgage loans.

For small business and small farm loans, as an Intermediate Small Bank you are not required to file a CRA Loan Register. The bank has the option to collect small business and small farm loans in the standardized CRA Loan Register format for presentation during the bank's CRA examination. As an Intermediate Small Bank, the bank reserves a unique option not available for Large Banks to consider loans with a supported community development purpose as either a Community Development Loan or a small business or small farm loan, depending on bank need and strategy.

As with a Small Bank's CRA examination, as an Intermediate Small Bank, the bank's lending activity will be evaluated under a standalone Lending Test which is comprised of five areas:

- The bank's loan-to-deposit ratio;
- The percentage of loans located within the bank's CRA Assessment Areas, sometimes referred to as the inside-outside lending ratio;
- The bank's record of lending to borrowers of different income levels and businesses and farms of different sizes;
- The geographic distribution of the bank's loans, with a focus on lending in low- and moderate-income census tracts; and
- The bank's record of taking action in response to written complaints about its performance in helping to meet the credit needs of its CRA Assessment Areas.

As part of the bank's CRA examination, a rating will be assigned for the bank's lending performance based on the evaluation of these five factors as well as a review of institutional capacity, performance context and other data.



Expanding into Community Development

The biggest change, both operationally and as part of the examination process, is the expanded focus on community development for Intermediate Small Banks. Unlike before, as an Intermediate Small Bank, the bank will now be evaluated under a separate Community Development Test as part of its CRA examination. This new Community Development Test will assess the bank's performance in meeting community needs by evaluating:

- The number and amount of Community Development Loans;
- The number and amount of Qualified Investments;
- The extent to which the bank provides Community Development Services; and
- The bank's responsiveness to community needs through such activities.

Within the CRA, a detailed definition is provided for which types of activities constitute "community development" and thereby receive positive consideration as part of the bank's CRA examination. "Community Development" includes affordable housing for low- and moderate-income (LMI) individuals; community services targeted to LMI individuals; economic development activities that finance small businesses or farms that meet size eligibility stan-

dards or have gross annual revenues of \$1 million or less; and activities that revitalize or stabilize LMI geographies, designated disaster areas, or distressed or underserved non-metropolitan middle-income geographies.

While the definition of community development and which activities qualify may seem fairly straightforward and intuitive, the reality is much more complex. Each one of the components of the community development definition has its own nuances that must be considered. The Interagency Questions and Answers on CRA last updated in 2016 also present dozens of scenarios and examples that further expand the types of activities that may receive positive consideration during a bank's CRA examination. Unfortunately, the details of each of those examples cannot be discussed in the limited space of this article but should be studied by any CRA Officer to ensure that his or her bank receives the most credit for CRA activities conducted by the bank.

Remember that for a bank's activity to qualify for community development, it must have a "primary purpose" of community development. As set forth in CRA guidance, this means that the activity must have an express purpose of community development either evidenced by the fact that the majority of the dollars or beneficiaries of the activity align with a community development

purpose or that the activity has a *bona fide* intent and structure designed to accomplish an express community development purpose. While many activities may have a tangential community development impact, they are unlikely to receive CRA credit if a primary purpose of community development is not present and documented.

It is also critical for a bank to demonstrate that its CRA activities are responsive to community needs. To evaluate responsiveness, bank examiners will not only look at the volume and type of the bank's CRA activities but will also evaluate qualitative aspects to determine effectiveness. Activities will be considered most responsive if they are successfully meeting credit and community development needs in the bank's CRA Assessment Areas. As mentioned above, bank examiners will also consider relevant performance context presented by the bank illustrating community needs, competition, market factors, constraints or other data that explain details about the bank's markets and community needs within them.

Generally, bank community development activities must also be located within the bank's CRA Assessment Areas to receive consideration during the bank's examination. Bank examiners will evaluate the bank's activities within its CRA Assessment Areas first. If the bank

has demonstrated that it is responsive to community needs within its CRA Assessment Areas, bank examiners can also consider activities that support a larger geographic area that includes the bank's CRA Assessment Areas such as a broader regional area or state.

Dig Into the Details

It is imperative that the bank's CRA Officer and staff understand the many ways in which the bank can receive credit for its Community Development Loans, Qualified Investments, and Community Development Services. Each one of these activities has its own requirements for evidencing CRA alignment. Documenting the details of how each activity meets regulatory expectations will be key to a successful examination as an Intermediate Small Bank.

Community Development Lending is an important component of the Community Development Test, encompassing loans that have been originated by the bank during its current examination cycle where the bank can support a community development primary purpose. Such loans could include affordable housing for LMI individuals or loans to revitalize or stabilize an LMI geography. Community Development Loans could also include loans that facilitate the creation of permanent jobs for LMI workers; loans to support organizations providing community services to LMI individuals; and loans to develop community facilities or infrastructure in distressed or underserved communities such as utilities or access to broadband internet.

For Intermediate Small Banks, loans with a qualified community development purpose in any dollar amount, that have not been reported on the bank's HMDA Loan Application Register, could be submitted for consideration as a Community Development Loan. In the case of a HMDA-reportable multi-family loan to develop affordable housing for LMI individuals, that loan can also be reported as a Community Development Loan even though it also appears on the bank's HMDA Loan Application Register. One important consideration in deciding which small business or small farm loans to report as Community Development Loans is determining the overall impact to both the bank's Lending and Community Development Tests, making sure that reporting in one area does not negatively impact the other. Any Paycheck Protection Program (PPP) loan originated by the bank in an LMI census tract or distressed or underserved area can automatically be considered as a Community Development Loan as stated in the Interagency FAQs last updated in March 2021; all other PPP loans must have a supported community development purpose to qualify as Community Development Loans.

When evaluating Qualified Investments, banks should consider both large-dollar investments and smaller donations or grants made by the bank. Large-dollar Qualified Investments could include tax credits, municipal bonds, or mortgage-backed securities purchased by the bank, as long as a community development primary purpose can be supported. Qualified investments could also include financial investments made with certain kinds of entities such as Community Development Financial Institutions, minority- or women-owned financial institutions, and more, as outlined in the CRA regulations. Bank donations or grants, including in-kind donations, can also be included as Qualified Investments, if the bank can document a community development primary purpose for these donations. Unique to Qualified Investments, banks can also receive credit for prior period investments that are still outstanding at the time of the bank's examination and

should value those investments based on their book value at the time of the examination.

Intermediate Small Banks will also be evaluated on Community Development Services conducted by bank employees. In order to receive credit for employee service, bank employees must provide service as a representative of the bank and must provide financial or job expertise as part of each service. The service must also be provided to a qualified community development organization or program or a CRA-qualified population such as LMI individuals, LMI workers, or students at schools where the majority of students are eligible for federal free and reduced lunch programs.

Be Ready for Your Next Exam

Ultimately, as with anything in CRA, a key to a successful examination lies with documenting the details about the bank's CRA activities. While it may seem daunting to understand all of the ins and outs of the expansive rules related to community development, it is important to concentrate on the scenarios that best fit with your bank's actual activities. Remember, bank examiners will consider any information that you provide outlining CRA qualifications of bank activities, so be sure to include specific data on how each loan, investment, or service activity aligns with regulatory expectations. By providing strong documentation that supports your CRA activity, you will be in a better position to sail through your next exam. ■

ABOUT THE AUTHOR



BRIAN WATERS, CRCM, is the President, COO and Co-Founder of findCRA, which offers both 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 over 20 years of experience in banking compliance and community development and is a resident of Louisville, KY. Contact him at brian@findCRA.com.

ABA MEMBER RESOURCES:

Community Reinvestment Act
[aba.com/banking-topics/compliance/acts/community-reinvestment-act](https://www.aba.com/banking-topics/compliance/acts/community-reinvestment-act)

Online Training: CRA (Community Bank)
[aba.com/training-events/online-training/cra-community-bank-for-compliance-professionals](https://www.aba.com/training-events/online-training/cra-community-bank-for-compliance-professionals)

Online Training: CRA (Large Bank)
[aba.com/training-events/online-training/cra-large-bank-for-compliance-professionals](https://www.aba.com/training-events/online-training/cra-large-bank-for-compliance-professionals)