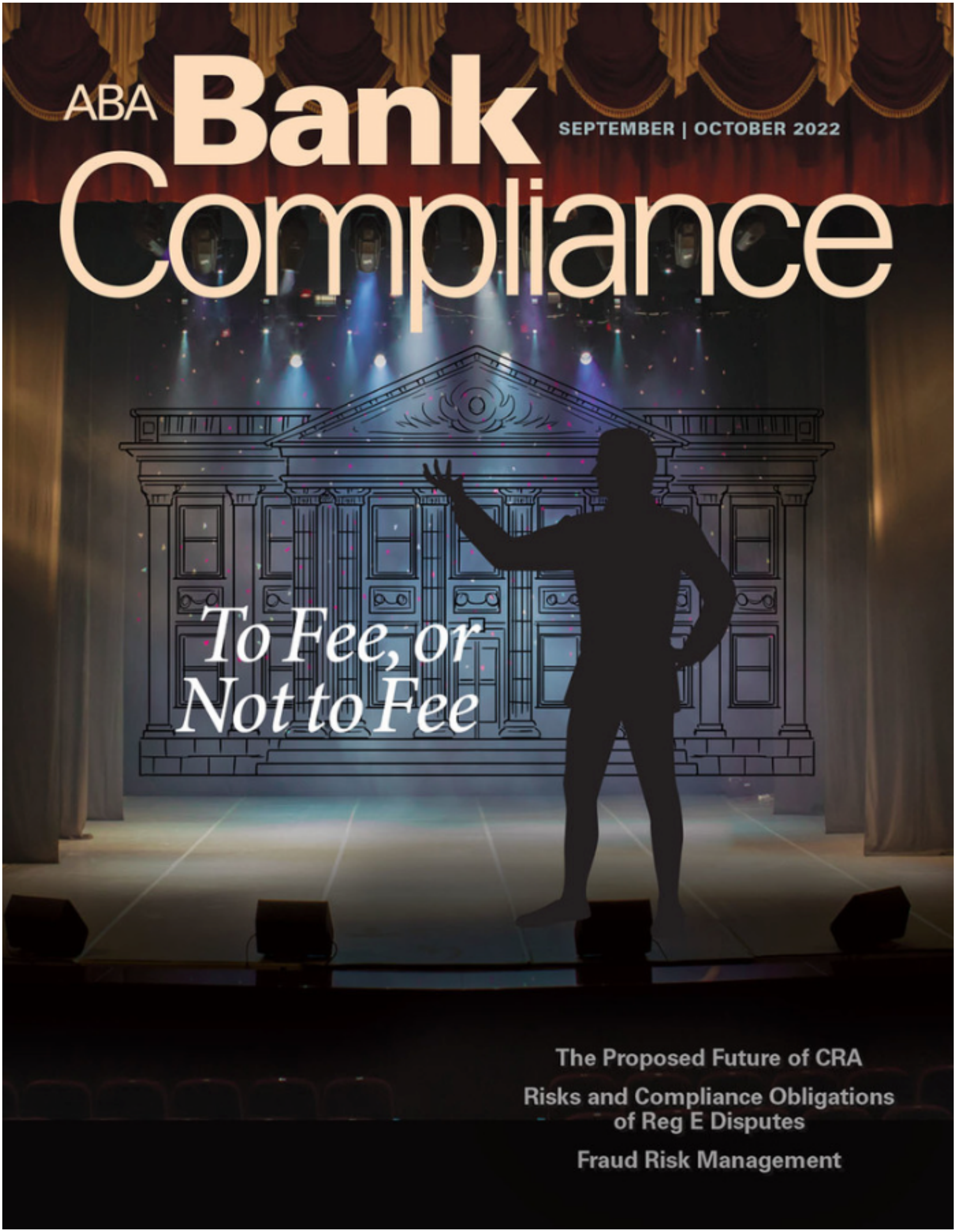
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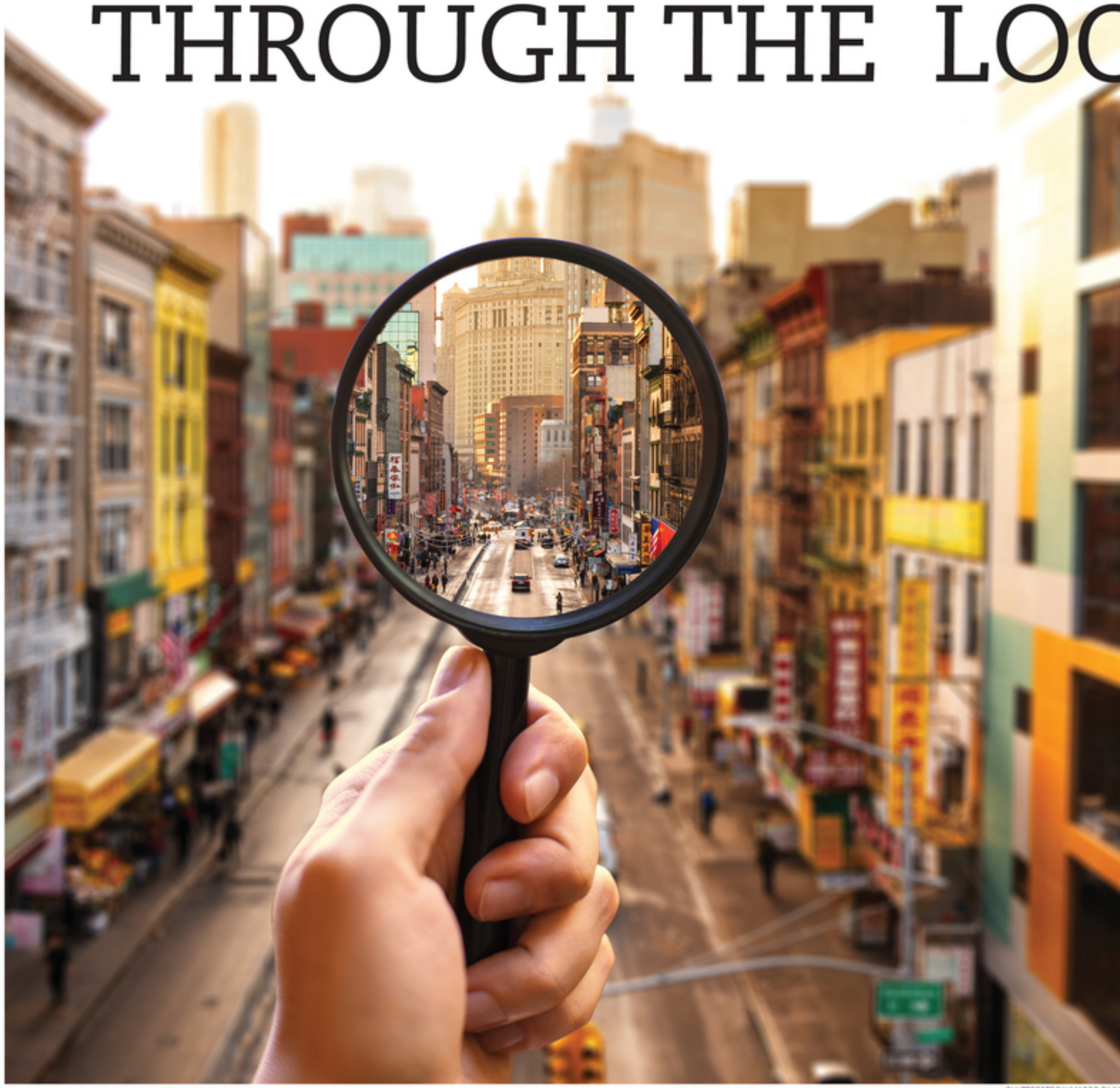

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A Glimpse at the Proposed Future of CRA

BY BRIAN WATERS, CRCM

AFTER A LONG AND WINDING JOURNEY, the new interagency Community Reinvestment Act (CRA) modernization proposal is finally here. What started with a 30-page memo from the Treasury Department in 2018 has resulted in a 650-plus page proposed rule covering the most expansive changes to the CRA since 1995. The proposal incorporates feedback and insights gleaned from the many iterations and attempts to update the CRA including the OCC's rescinded 2020 final rule and the Federal Reserve's independent proposal. While an in-depth analysis of the proposed rule could easily fill an entire issue of this magazine, this article will guide you through a summary of the primary changes proposed by the banking agencies.

Call to Action

Over the past several years, the agencies have explored various ways to modernize CRA. Through the new interagency proposed rule, the agencies have stated their intent to focus on several key considerations including:

- Updating the CRA regulations to strengthen the achievement of the core purpose of the rule;
- Adapting to changes in the banking industry, including the expanded role of mobile and online banking;
- Providing greater clarity and consistency in the application of the regulation;
- Tailoring performance standards to account for differences in bank sizes, business models, and local conditions;
- Tailoring data collection and reporting requirements while using existing data whenever possible;
- Promoting transparency and public engagement;
- Confirming that CRA and fair lending responsibility are mutually reinforcing; and
- Creating a consistent regulatory approach that applies to banks regulated by the agencies.

With these goals in mind, the agencies have provided a comprehensive approach to modernizing CRA with new standards for delineating assessment areas, new definitions for qualifying CRA activities, and new data collection and recordkeeping requirements. Most importantly, the agencies have designed a new metrics-based evaluation framework for assessing CRA performance for large banks, replacing the historical three-prong CRA test with an analytical four-prong test, rooted in comparative benchmarks and driven by data. While much of the proposed rule echoes the prior methodology for CRA, the changes are expansive, especially for the largest banks.

Reshaping Bank Sizes and Affiliate Relationships

The agencies have adjusted asset-based thresholds for bank performance evaluation. As proposed, the asset threshold for small banks would increase from \$346 million to \$600 million, with an estimated 778 banks that are currently designated as intermediate small banks transitioning to the small bank designation. Similarly, the asset threshold

Editor's Note: Typically, we only cover final rules, however, since this new rule will create such sweeping changes in how bank CRA activity will be assessed, we felt it was appropriate in this case. Please keep in mind that as of publication, this is strictly a proposed rule.

for intermediate banks would increase from $1.384 billion to $2 billion, with an estimated 216 banks that are currently designated as large banks transitioning to the intermediate bank designation.

The agencies also propose requiring the inclusion of relevant activities of certain affiliates that meet new definitions of "operations subsidiaries" or "operating subsidiaries" defined as organizations designed to serve, in effect, as a separately incorporated department of the bank, performing functions that the bank is empowered to perform directly at locations at which the bank is authorized to engage in business. The bank could elect to have other affiliate activity evaluated as part of the bank's CRA examination as well.

Redefining Community Development

At the core of CRA performance for many banks is determining how bank activities are aligned with regulatory definitions of community development. Within the proposed rule, the underlying spirit of community development remains the same, supporting that bank activities must demonstrate a primary purpose of community development to qualify for CRA consideration during bank examinations.

Affordable housing remains focused on those bank activities that support homeownership and affordable housing costs for low- and moderate-income (LMI) individuals. The proposed rule clarifies that housing activities conducted through a government plan, program, initiative, tax credit, or subsidy with a stated purpose or intent of affordable housing qualify for CRA consideration. Mortgage-backed securities will continue to be viewed as supporting affordable housing if a majority of underlying mortgages were made for single-family home mortgages for LMI individuals or for qualified multifamily affordable housing.

The agencies have provided greater clarity in how "naturally occurring affordable housing"—housing that is affordable to LMI individuals but not supported or facilitated by government programs, subsidies, or tax credits—will be evaluated under for CRA alignment. Banks can receive credit for such activities if the majority of housing units do not exceed 30 percent of 60 percent of the Area Median Income, a change from prior guidance. Furthermore, these activities must now meet at least one of four criteria to qualify, including:

- Located in an LMI census tract;
- Undertaken in partnership with a nonprofit organization with a stated mission of, or that directly supports, affordable housing;
- Developed under an explicit written affordability pledge from the property owner to maintain affordable rents; or
- Have documentation that the majority of residents will be LMI.

At the core of CRA performance for any bank is determining how bank activities are aligned with regulatory definitions of community development.

Economic development activities will have a more targeted focus on directly supporting small businesses and small farms. These activities could be undertaken as part of a government plan, program, or initiative or through financial intermediaries who increase access to capital to businesses or farms with gross annual revenues of $5 million or less. Technical assistance, such as co-working space, shared technology, or administrative assistance to small businesses or small farms, would continue to qualify as well. However, workforce development and job training programs would no longer be considered under economic development but instead be assessed as community supportive services under the proposed rule.

Community supportive services would include those general welfare activities that serve or assist LMI individuals such as childcare, education, workforce development, job training, and health services. Prior income guidance for determining LMI alignment, such as the percent of students eligible for USDA Free or Reduced Lunch programs or individuals eligible for Medicaid, would remain in effect.

Under the proposed rule, the most expansive changes to activity qualification impacts revitalization efforts, which now include six types of activities, including:

- Revitalization activities undertaken with government plans, programs or initiatives;
- Essential community facilities;
- Essential community infrastructure;
- Recovery activities in designated disaster areas;
- Disaster preparedness and climate resiliency activities; and
- Activities in Native Land Areas, with substantial benefits to LMI residents.

While some of these activities are familiar, two new areas—disaster preparedness/climate resiliency and activities in Native Land Areas—are completely new for CRA consideration. The agencies have shifted focus from the prior requirement of attracting new, or retaining existing residents and businesses to a new four-prong approach to demonstrating revitalization. Under the proposed rule, revitalization activities must:

- Have a geographic focus in a targeted area such as an LMI census tract or distressed or underserved area;

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- Benefit local residents, including LMI residents in the targeted geography;
- Not displace or exclude LMI residents in the targeted geography; and
- Be conducted in conjunction with a government plan, program, or initiative that includes an explicit focus on benefitting the targeted geography.

The agencies have restated their commitment to bank activities that support specialized financial institutions, including minority-owned and women-owned depository institutions, low-income credit unions, and Treasury Department-certified Community Development Financial Institutions or CDFIs.

A new separate community development criterion for financial literacy activities is proposed. Going forward, bank-supported financial literacy activities would no longer need to be primarily focused on LMI individuals to qualify for CRA consideration. Banks would receive consideration for any financial literacy activities regardless of the income level of the beneficiaries, provided that the activities are not designed in a way to target only middle- or upper-income individuals.

As with other CRA modernization proposals, the agencies have committed to providing a non-exhaustive, illustrative list of examples of qualifying activities that will be periodically updated. Banks will also have access to a process to submit planned activities to the agencies for confirmation of eligibility.

Redrawing Assessment Areas

Banks would continue to delineate CRA assessment areas based on the location of a bank's main office, branches, and deposit-taking remote service facilities. These geographies would be renamed "facility-based assessment areas" under the proposed rule and include any staffed physical location that is open to bank customers or a remote-facility that takes deposits, but would continue to exclude loan production offices. For large banks under the proposed rule, a facility-based assessment area could be no smaller than a full county; however, intermediate and small banks could continue to delineate partial counties.

Banks would continue to delineate CRA assessment areas based on the location of a bank's main office, branches, and deposit-taking remote service facilities.

The proposal also introduces "retail lending assessment areas" for large banks. These new assessment areas would be required to be designated as geographies where the bank has a concentration of lending outside of facility-based assessment areas. For any single Metropolitan Statistical Area (MSA) or non-MSA area of state where a bank has originated at least 100 home mortgage loans or 250 small business loans in the preceding two calendar years, the bank would be required to delineate a retail lending assessment area. In each of these new retail lending assessment areas, the bank would be evaluated for lending performance under the Retail Lending Test for all identified major product lines.

For all remaining lending activity conducted by a large bank outside of its facility-based and retail lending assessment areas, lending activity would be aggregated and assessed at the institution level. This multi-step approach ensures that all bank retail lending activity will be evaluated as part of the bank's CRA examination.

Performance context will continue to play an important role in documenting specific factors that affect the bank's activities or ability to meet community needs. While some performance context factors, such as demographic data on LMI individuals and small business, would be incorporated into the new evaluation methodology, other data will be important for banks to present as part of their CRA evaluation. Under the proposed rule, information on the bank's capacity and constraints, business strategy, community needs, and opportunities for CRA activities would still be considered as part of the bank's CRA evaluation.

Redesigning CRA Performance Evaluations

In order to provide greater transparency and consistency in the evaluation of bank CRA performance, the agencies have designed a new methodology for assessing CRA performance at large banks consisting of four new CRA tests including:

- The Retail Lending Test;
- The Retail Services & Products Test;
- The Community Development Financing Test; and
- The Community Development Services Test.

For small and intermediate banks, for the most part, the examination process will remain the same as it is today, unless a bank elects to be evaluated under one or more of the new tests. Similarly, banks can still operate under a strategic plan or with a wholesale or limited purpose designation; however, each of these bank designations have their own proposed changes and new approaches to assessing performance under the proposed rule as well.

Retail Lending Test

Under the new Retail Lending Test, bank activity would be evaluated in up to six newly defined major product lines including closed-end home mortgages, open-end home mortgages, multifamily loans, small business loans, small farm loans, and automobile loans. In each assessment area, a major product line is identified when at least 15 percent of a bank's retail lending by dollar volume is included in one of the defined major product lines. Mortgage loans include one-to-four family dwelling secured loans. Small business and small farm loans align with definitions set forth in the CFPB's proposed Section 1071 rule (as businesses or farms with gross annual revenues of $5 million or less). No consumer loans would be evaluated under the proposed rule aside from automobile loans.

To evaluate retail lending performance, the agencies are proposing a two-prong, metrics-based approach. First, bank performance would be assessed using a retail lending volume screen that assesses the level of a bank's retail lending relative to its deposit base in each of the bank's facility-based assessment areas compared to peer lender performance. The bank's lending volume, as measured by the bank volume metric, would be compared to a market volume benchmark that reflects the level of lending by all large banks in each facility-based assessment area. In order to pass the retail lending volume screen, the bank volume metric would need to be at least 30 percent of the market volume benchmark. If the

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bank fails to meet this screen, then the bank could be rated "needs to improve" or "substantial noncompliance" unless performance context explains the bank's underperformance.

Once a bank passes the retail lending volume screen, bank lending performance would then be evaluated based on loan distribution by geographic and borrower metrics. The geographic distribution metric would measure the level of bank lending in LMI census tracts. The borrower distribution metric would measure the level of bank lending to LMI borrowers or small businesses and small farms with gross annual revenues of $250,000 or less and between $250,000 and $1 million dollars. To measure performance, the agencies would evaluate the number of loans originated for each metric in each major product line in each of the bank's assessment areas. For multifamily loans, the agencies propose only evaluating geographic distribution.

Once the bank's distribution of lending has been determined, bank retail lending performance would be compared to specific quantitative standards including community benchmarks that reflect demographics of an assessment area, such as the percentage of owner-occupied housing units or families who are low-income, and market benchmarks that reflect aggregate loan originations by all reported lenders. Using these thresholds and benchmarks, bank lending activity would be assigned a point-value using a new ten-point rating scale. Bank scores could be qualitatively adjusted based on additional factors. For example, scores could be adjusted up or down due to data manipulation by the bank, performance context, loan churning, data anomalies, or lack of LMI census tracts in an assessment area.

The agencies will assign ratings to bank performance in each of the bank's assessment areas using this new methodology. For state and multistate MSA ratings, the agencies will weight bank performance based on the percentage of bank's retail loans made and deposits sourced in each assessment area. At the institution level, lending performance conclusions will be assigned by combining conclusions from each assessment area and outside area performance.

Retail Services & Products Test

The new Retail Services & Products Test will evaluate delivery systems and credit and deposit products which are responsive to LMI communities' needs for all large banks using a primarily qualitative approach.

The first component of this new test is the delivery systems evaluation, which will assess branch availability and services and remote service facility availability for all large banks. For large banks with assets over $10 billion, an additional assessment of digital and other delivery systems is also required.

Examiners will assess the distribution of bank branches across census tract income levels; the bank's record of branch openings and closings; and banking hours or operations and services with a focus on responsiveness to LMI individuals and communities. Branch distribution would be compared to new market benchmarks that measure the distribution of all bank branches within a facility-based assessment area and compared to the distribution of census tracts, households, and businesses or farms.

The agencies also propose favorable consideration for banks that operate branches in areas with low branch access or very low branch access, a concept that was first introduced in the OCC's 2020 rule as "banking deserts." These areas would be defined geographically as areas with little or no bank branches within a certain distance from census tract boundaries or population centers.

Remote service facility availability would be evaluated similarly to branch availability in comparison to qualitative benchmarks. Bank partnerships with remote service facility providers that expand access, such as fee-waiver alliances for out-of-network usage, would also be evaluated.

For large banks with assets over $10 billion, and optionally for all large banks, the availability and responsiveness of digital delivery systems such as online or mobile banking or other delivery systems would be evaluated. The availability of services to all income levels, the range of services offered, and the bank's overall strategy to serve LMI individuals would be reviewed. For measuring digital activity, the agencies may consider the number of accounts opened and overall usages of delivery systems.

All large banks would also be evaluated at the institution level under a second component that evaluates the availability of credit and deposit products including the extent to which such products are responsive to the needs of LMI individuals, small businesses, and small farms. While all large banks' credit products would be evaluated, an evaluation of deposit products would only be required for large banks with assets over $10 billion.

Bank performance under the Retail Services & Products Test would be assigned conclusions based on the same ten-point rating scale used under other tests. Examiners would deploy their own judgment in determining the weight for each component.

Community Development Financing Test

The new Community Development Financing Test would apply to all large banks, and any other bank that opts into evaluation under the new test. The test consists of a new community development financing metric and impact review for each facility-based assessment area as well as at the state, multistate MSA, and institution level for each bank. However, retail lending assessment areas are excluded.

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For all remaining lending activity conducted by a large bank outside of its facility-based and retail lending assessment areas, lending activity would be aggregated and assessed at the institution level. This multi-step approach ensures that all bank retail lending activity will be evaluated as part of the bank's CRA examination.

The volume of bank activities would be based on the annual average dollars of community development financing activities loaned or invested. This measurement includes both new activities during the current evaluation cycle as well as the annual quarterly average of loans or investments in prior years that have remained on the bank's balance sheet. This new approach allows banks to receive credit to both prior period investments and Community Development Loans that are still outstanding at the time of the bank's CRA evaluation.

This new test measures the bank's dollar value of all Community Development Loans and Community Development Investments (formerly, Qualified Investments) relative to the bank's capacity as reflected by the dollar value of deposits. Under the new test, all lending and investment activity would be reviewed together and compared to benchmarks that would reflect local context. Additionally, an impact review would evaluate the impact and responsiveness of bank activities through the application of series of specific qualitative factors.

Bank activities would be allocated based on the geographic area that they serve, with the bank documenting the county, state, or multistate area that benefitted. If an activity benefits a statewide area, it would be allocated to the state and not individual counties within the state. Bank performance would be compared to both a local benchmark and a nationwide benchmark, adjusted based on impact review factors, and assigned conclusions utilizing the same ten-point rating scale utilized in other tests.

Community Development Services Test

Under the fourth test, each large bank's record of community service would be evaluated qualitatively. The agencies propose retaining the current definition of *community development services* that includes services conducted by bank employees or board members, having a primary purpose of community development, and related to the provision of financial services.

Within nonmetropolitan areas, banks would have more flexibility as the requirement that the service includes financial expertise would be eliminated. As opportunities for service may be more limited and community needs more unique, any qualified community development service could be considered in these communities. For large banks with assets over $10 billion, service activity would be evaluated in comparison to a standardized metric based on the number of service hours relative to full-time equivalent employees in each facility-based assessment area.

Reevaluating Data Collection & Reporting

To support the new metrics-based approach to CRA performance evaluation, the agencies are proposing a significant expansion of CRA data collection, recordkeeping, and reporting.

For large banks with assets over $10 billion, expanded data collection includes data on deposits, retail services, digital delivery systems, responsive deposit products, community development services, and automobile lending data. All large banks would be required to collect and report data on community development financing, branch locations, remote service facility locations, and delineation of assessment areas.

Under the proposal, when small business and small farm reporting under the CFPB's Section 1071 rule becomes effective, the data collected under this new rule would replace the current CRA Loan Register process. The agencies also propose to include an analysis of home mortgage lending by race and ethnicity based on HMDA data within the bank's CRA Public Evaluation report, although this analysis would not constitute a fair lending review and have no direct impact on CRA conclusion or ratings.

The agencies are currently exploring the best process for reporting new data, whether through existing data sources or new standardized templates. As proposed, the required reporting date would also move from March 1st to April 1st and data would be required to be reported annually.

What's Next?

Within the proposal, the agencies state that most changes would become effective twelve months after the publication of a final rule for activities going forward, providing a one-year transition period. CRA examinations under the new methodology would begin two years after the publication of a final rule.

The comment period has closed for the proposed rule and we await publication of a final rule that will dramatically update the CRA evaluation process. It remains to be seen if in practice this new rule will provide greater transparency and consistency for the general public and banks to determine and anticipate CRA performance. And more importantly, if it will identify and support community needs and foster economic inclusion. ■

ABOUT THE AUTHOR

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