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Legal Update

Better for Banks? Proposed Community Reinvestment Act Regulations Would Mean Big Changes

On December 12, 2019, the US Federal Deposit Insurance Corporation ("FDIC") and the Office of the Comptroller of the Currency ("OCC") together proposed extensive updates to their Community Reinvestment Act ("CRA") regulations (85 Fed. Reg. 1204 (Jan. 9, 2020)). In their joint notice of proposed rulemaking ("Proposal"), the agencies identified four objectives: (1) clarify and expand the types of activities that qualify for CRA credit; (2) update and expand the areas in which qualifying activities receive credit; (3) provide a more objective and transparent method to measure and evaluate CRA performance; and (4) revise data collection, recordkeeping, and reporting requirements to improve consistency. With these goals in mind, the agencies propose to maintain and publish a running list of the types of activities that qualify for CRA credit. They would also modernize the CRA by redefining bank "assessment areas," getting away from a strictly brick-and-mortar focus to account for advancements in technology and changes in how consumers choose to bank.

Previously, the OCC, FDIC and the Board of Governors of the Federal Reserve System ("Federal Reserve") have issued regulations to implement the CRA. While the agencies have more recently issued frequently asked questions, the last major revisions to the regulations were made in 1995. At this point, the Federal Reserve has declined to join the Proposal and is hoping to solicit public comment on a broader set of options. (See Lael Brainard, "Strengthening the Community Reinvestment Act by Staying True to its Core Purposes" at Urban Institute (Jan. 8, 2020).) Unless resolved, the lack of agreement among the OCC, FDIC and the Federal Reserve could create different standards for depository institutions based on their primary regulators. This could complicate compliance with the CRA for many institutions and cause confusion among the various stakeholders.

In this Legal Update, we expand on our earlier blog post by describing the changes the Proposal would make to CRA qualifying activities, explaining how the Proposal changes a bank's assessment areas and CRA performance measurements and identifying key changes to data collection and reporting requirements.

Qualifying Activities

The agencies explained that the Proposal's qualifying activities provisions are meant to provide certainty, transparency and consistency, with the goal of encouraging banks to undertake more CRA activities and incentivize them to commit more financial resources to populations and areas that need them most, such as low- to moderate-income ("LMI") individuals, distressed areas, underserved areas and Indian country.

Under the current regulatory framework, it may take years for a bank to receive the results of a CRA examination, which are unpredictable due to inconsistencies from one evaluation to the next. The current framework leaves banks uncertain about whether a community development ("CD") activity will qualify, resulting in a disincentive for banks to explore new activities. The Proposal attempts to address this concern by clarifying and expanding the activities that qualify for CRA credit, focusing on a bank's ongoing commitment to CRA and publishing a list of examples of qualifying activities.

1. Clarifying and expanding the activities that qualify for credit

A "qualifying activity" is any activity that meets the credit needs of a bank's community, particularly those individuals, areas and populations with needs. These include all of the activities that currently qualify for CRA credit, as well as additional activities that meet the credit needs of economically disadvantaged individuals and areas in banks' communities.

The intended effect of the Proposal is to expand the type of activities that qualify for CRA credit; the agencies make clear in the Proposal that they do not intend to reduce the activities that qualify. For example, activities where a bank provides the economic resources and is substantively engaged in the activity would qualify for credit. Current practice is to recognize these activities as being conducted by the bank, at the bank's option. Under the Proposal, the agency would automatically recognize activities substantively conducted by the bank.

To this end, the Proposal eliminates certain ambiguous or unclear terms such as "economic development" and "revitalize and stabilize" in favor of describing in greater detail the activities that would qualify. The existing regulations include a general aspect of economic development that requires a bank to demonstrate that its activities supporting small businesses or farms support job creation, retention and improvement for LMI individuals, LMI census tracts and other targeted areas. But the agencies were never able to identify an objective method for demonstrating *how* to satisfy this requirement other than by determining if the activity would create additional low-wage jobs. Under the Proposal, this economic development concept would be eliminated entirely and replaced with specific illustrations of the kinds of activities that currently qualify as economic development activities.

The Proposal also would revise the definition of "distressed area," which is currently limited to nonmetropolitan areas, to recognize that urban areas may also experience high rates of poverty, unemployment or population loss and need financial resources. Similarly, the Proposal would revise the definition of "underserved area" to remove the requirement that these census tracts be nonmetropolitan areas. Instead, underserved areas may include metropolitan census tracts with a lack of banking and other services as defined in the Proposal.

RETAIL LENDING

The Proposal would expand the retail lending criteria to include home mortgage loans and consumer loans provided in Indian country and loans of $2 million or less to a business or farm that either (i) has annual revenue of $2 million or less, adjusted annually for inflation, or (ii) is located in an LMI census tract. These increases to the revenue and size thresholds are intended to account for inflation since the current thresholds were established in 1995 and to incentivize banks to engage in small business and farm lending. Under the Proposal, qualifying retail loans include:

- A retail loan (defined to include home mortgage loans, small loans to businesses, small loans to farms and consumer loans) provided to:
  - An LMI individual,
  - A small business or
  - A small farm.
- A retail loan provided in Indian country.
- A retail loan that is a small loan to a business or a small loan to a farm located in a low- or moderate-income census tract.

CD ACTIVITIES

Qualifying CD activities include a CD activity that provides financing for or supports[1]:

- **Affordable housing** that partially or primarily benefits LMI individuals or families or middle-income individuals or families in high-cost areas (affordable housing includes "naturally occurring" affordable housing, such as unsubsidized rental housing with affordable rents). This would include activities that finance or support owner-occupied housing purchased, refinanced or improved by LMI individuals or families, such as an investment provided to a nonprofit that constructs or rehabilitates affordable housing for purchase by LMI individuals. This criterion would also capture mortgage-backed securities;
- **Another bank's** CD loan, CD investment or CD service (encouraging interbank collaboration, such as a large bank financing a community bank's project);
- **Community support** services (e.g., childcare, education, health services and housing services) that partially or primarily serve LMI individuals or families;
- **Essential community facilities** that partially or primarily benefit or serve LMI individuals or areas of identified need, such as distressed areas or Indian country;
- **Essential infrastructure** that benefits or serves LMI individuals or areas of identified need (recognizing that essential infrastructure projects are often community-wide projects, this could include, e.g., investment in a mass transit project that serves the greater public, including LMI individuals);
- **Family farms** (family farm purchases or leases of farm land, equipment and other inputs or the sale and trade of family farm products, as well as technical assistance and supportive services);
- **Federal, state, local or tribal government programs**, projects or initiatives that partially or primarily benefit LMI individuals (e.g., a program that supports urban renewal), small businesses, small farms and areas of identified need;
- **Financial literacy** programs or education or homebuyer counseling that benefits individuals of all income levels;
- **In Indian country, owner-occupied and rental housing** development, construction, rehabilitation, improvement or maintenance to address concerns about significant housing needs in Indian country that affect individuals of all income levels;

- **Qualified opportunity funds** that benefit LMI opportunity zones, which are areas the government has identified as needing economic development and job creation;
- **A Small Business Administration** Certified Development Company (SBDC), Small Business Investment Company (SBIC), New Markets Venture Capital (NMVC) company, qualified Community Development Entity (CDE) or US Department of Agriculture Rural Business Investment Company (RBIC);
- **Technical assistance and supportive services** for small businesses or small farms; or
- **A capital investment, loan participation or other venture** undertaken by a bank in cooperation with a minority depository institution, women's depository institution, CDFI, or low-income credit union that helps meet the credit needs of the institution's or credit union's local communities, including through activities that indirectly help meet community credit needs by promoting the institution's or credit union's sustainability and profitability.

To expand further on the type of activities that qualify for CRA credit, banks also would receive credit for services other than financial services, such as volunteer hours, and would receive pro-rata partial credit for CD activities that provide some benefit to, but do not primarily benefit, specified populations, entities or areas.

2. Focus on the bank's ongoing commitment

Some stakeholders had expressed concern that the current regulatory framework gives too much CRA credit to certain loans or investments regardless of how long they remain on the bank's balance sheet. The current framework does nothing to disincentivize churn, resulting in banks often taking a short-term approach to CRA activities. To address this concern, the Proposal would focus on the bank's ongoing commitment to lending and investment by giving a bank CRA credit for the average month-end outstanding amount on the bank's balance sheet of any qualifying loan or CD investment and would credit the bank for the amount of CD services and monetary and in-kind donations made during the period. The agencies believe this approach will help eliminate the apparent inflation of the level of CRA activity that results from banks purchasing loans or mortgage-backed securities just prior to a CRA evaluation and selling them immediately after.

3. Qualifying activities illustrative list

The Proposal includes an initial *non-exhaustive*, illustrative list of examples of activities that would or would not qualify for CRA credit. The list would be revised at least every three years through a public notice and comment process, to address new or outdated activities, and would be published on the agencies' websites. Stakeholder comments are invited regarding where and how often the list should be updated.

The Proposal also would create a process through which a bank could submit a form through the agency's website to seek confirmation that an activity is a qualifying activity. The agencies emphasize however that such a process would not be compulsory; instead, they expect a confirmation process would be used sparingly because banks have the ability to discuss with their examiners whether an activity qualifies and to make their own determinations by evaluating the activity in light of the proposed qualifying criteria.

4. Calculating the value of qualifying activities

The Proposal would assess both the number of CRA activities and their dollar value and would set a threshold for the total dollar volume of CRA activities. To determine their presumptive CRA ratings at the bank level and in each assessment area, banks evaluated under the general performance standards[2] would sum the values of all qualifying activities, adjusted by any applicable multiplier as follows:

Qualifying Loans on balance sheet for at least 90 days and CD Investments	+	25% of the origination value of Qualifying Loans sold within 90 days of origination	+	CD Services and Monetary and In-kind Donations

Qualifying activities would be quantified as follows:

- Qualifying loans and CD investments would be valued based on their average month-end on-balance sheet dollar value, except that qualifying retail loans originated and sold within 90 days of origination would be valued at 25% of their origination value.
- Legally-binding commitments to invest that are reported on the Call Report would be valued based on their average month-end dollar value.
- Qualifying commitments to lend would be valued based on the average month-end dollar value of the allowance for credit losses on those commitments that are reported on the Call Report.
- CD services and monetary or in-kind donations would be credited at the value of the monetary donation or in-kind activity or at the hourly salary as estimated by the Bureau of Labor Statistics for the job category of the service provided for the number of hours provided.
- If a CD activity partially benefits the intended population or area, then the quantified value would be a *pro-rata* share of the full quantified dollar value of the activity.
- The quantified value of qualifying activities to CDFIs, other CD investments (not including MBS and municipal bonds) and other affordable-housing related CD loans would be adjusted upward by a multiple of two. The agencies are also considering whether to apply multipliers to smaller CD loans, which may be important to small non-profits with a CD purpose.

The agencies invite comment on this and all aspects of the Proposal. Among other things, they ask whether certain aspects of the Proposal are overly burdensome. For example, under the Proposal, a bank may receive credit for employees who provide services by calculating the compensation for that type of work using Bureau of Labor Statistics data. The agencies ask whether using standardized compensation values would reduce the burden of tracking CD services under the Proposal while still appropriately valuing such services.

Assessment Areas

Currently, a bank's CRA performance is measured within the bank's "assessment areas," which are areas surrounding a bank's brick-and-mortar locations and the surrounding census tracts in which the bank originated or purchased a substantial portion of its loans. The agencies suggest that this approach is outdated and that it actually creates disincentives for banks to meet the credit needs of their *entire* communities, resulting in pockets of either too little CRA activity or too much competition for CRA activity ("CRA deserts" and "CRA hotspots," respectively).

The Proposal would redefine assessment areas to include not only the areas where the bank has a physical presence or substantial lending (so-called "facility-based" assessment areas), but also additional areas where the bank has a concentration of retail domestic deposits. Any bank with a significant portion of its retail domestic deposits outside of its facility-based assessment areas (50% or more) would have to delineate additional assessment areas wherever it has a concentration of such deposits. Banks would have the option to choose the geographic level at which to delineate their facility-based assessment areas from a range of choices (e.g., MSA, the whole nonmetropolitan area of a state, etc.), but their separate, non-overlapping deposit-based assessment areas must be delineated at the smallest geographic level where they receive 5% or more of their retail domestic deposits. These deposit-based assessment areas would better capture banks' evolving business models, address the increased competition for deposits outside of banks' current assessment areas and encourage banks to serve the communities where they take deposits. These deposit-based assessment areas would consist of (1) a state; (2) a whole MSA; (3) the whole nonmetropolitan area of a state; (4) one or more whole, contiguous MDs in a single MSA; (5) the remaining geographic area of a state, MSA, nonmetropolitan area, or MD other than where the bank has a facility-based assessment area; or (6) one or more whole, contiguous counties or county equivalents in a single MSA or non-MSA.

Thus, under the Proposal a bank might have both facility-based assessment areas and deposit-based assessment areas. Banks would be permitted to change their assessment area delineations once per evaluation period. The Proposal also would allow banks to receive CRA credit for certain activities outside of their assessment areas because the agencies recognize that there are certain communities of need where banks have a limited physical presence or deposit-taking presence. By clarifying and expanding when banks can receive credit beyond the immediate areas surrounding bank branches, the Proposal would help reduce CRA hotspots and CRA deserts.

Measuring Performance

The Proposal describes at length the proposed new, objective, somewhat complex framework for evaluating CRA performance. Under the current evaluation system for CRA performance, banks and other stakeholders have frequently complained about the subjective nature of the evaluation process. The new general performance standards would assess two components: (1) the number of qualifying retail loans to LMI individuals, small farms and businesses, and LMI geographies in a community and (2) the quantified value of a bank's qualifying activities. A bank would determine its bank-level and assessment-area CRA evaluation measures annually as part of its CRA performance evaluation.

RETAIL LENDING DISTRIBUTION TEST

Under the first part of the evaluation, banks would apply a retail lending distribution test, and the agencies would validate their performance. The tests would be applied at the assessment-area level and would require that a bank meet minimum thresholds for each major retail lending product line[3] with at least 20 loans in that assessment area during the evaluation period. By requiring at least 20 originations in an assessment area before applying the retail distribution test, the agencies tried to ensure that they would only evaluate a bank's retail lending distribution in markets where it is engaged in retail lending beyond an accommodation basis. The Proposal describes a geographic distribution test that looks at a bank's distribution of lending in LMI areas and a borrower distribution test that assesses lending to LMI borrowers or small businesses or small farms. A bank can pass the tests by meeting or exceeding a threshold associated with the demographics of the assessment area (i.e., demographic comparator) or a threshold associated with peer performance in the given assessment area (i.e., peer comparator).

ASSESSMENT-AREA-LEVEL PERFORMANCE RATING

A bank's assessment-area CRA evaluation measure would be determined in each assessment area and would be the sum of (1) the bank's annual assessment area qualifying activities value divided by the average quarterly value of the bank's assessment area retail domestic deposits as of the close of business on the last day of the quarter for the same period used to calculate the annual assessment area qualifying activities value and (2) the number of the bank's branches located in low- or moderate-income census tracts in the assessment area divided by its total number of branches in the assessment area as of the close of business on the last day of the same period used to calculate the annual assessment area qualifying activities value multiplied by .01.

To receive a presumptive rating of satisfactory or outstanding at the assessment area level, two things have to happen. First, the bank's performance on the geographic and borrower lending distribution tests would have to meet or exceed the established thresholds for performance for each of its major retail lending product lines with at least 20 loans in that assessment area. Second, the average of the bank's CRA evaluation measures for an evaluation period would have to meet or exceed established benchmarks. The agencies included in the Proposal specific empirical benchmarks of 11% for outstanding, 6% for satisfactory, 3% for needs to improve and less than 3% for substantial noncompliance.

BANK-LEVEL PERFORMANCE RATING

Under the Proposal, a bank's bank-level CRA evaluation measure would be the sum of (1) the bank's annual bank-level qualifying activities values divided by the average quarterly value of the bank's retail domestic deposits as of the close of business on the last day of each quarter for the same period used to calculate the annual qualifying activities value and (2) the number of the bank's branches located in low- or moderate-income census tracts, distressed areas, underserved areas and Indian country divided by its total number of branches as of the close of business on the last day of the same period used to calculate the annual qualifying activities value multiplied by .01.

At the bank level, a bank's presumptive rating would be based on the comparison of its average bank-level CRA evaluation measure to the established benchmark, except that a bank could not receive a satisfactory or outstanding rating unless it also received that rating in a significant portion of its assessment areas and in those assessment areas where it holds a significant number of deposits.

The Proposal illustrates possible ways to achieve each category. The agencies included specific empirical benchmarks for each rating category in the Proposal that they believe would help achieve the positive outcome.

Presumptive Rating Category	**CRA Evaluation** *The average of a bank's annual assessment area CRA evaluation measures meets or exceeds:*	**Retail Lending Distribution Tests**	**CD Minimums**
Outstanding	11%	A bank meets the established thresholds for all of the retail lending distribution tests for its major retail lending product lines in that assessment area.	The quantified value of community development loans and community development investments in the assessment area divided by the average of the bank's assessment area retail domestic deposits must meet or exceed 2%.
Satisfactory	6%	A bank meets the established thresholds for all of the retail lending distribution tests for its major retail lending product lines in that assessment area.	The quantified value of community development loans and community development investments in the assessment area divided by the average of the bank's assessment area retail domestic deposits must meet or exceed 2%.
Needs Improvement	3%		
Substantial Noncompliance	< 3%		

A bank would use the empirical benchmarks and thresholds in effect on the first day of its evaluation period for the duration of its evaluation period. Banks that achieve a bank-level outstanding rating would be subject to a five-year CRA evaluation period unless the data reported indicates that an earlier evaluation is warranted. As with the current framework, a bank's CRA rating could be adversely affected by evidence of discriminatory or other illegal credit practices.

Data Collection, Recordkeeping and Reporting

Under the current CRA framework, banks collect and report a variety of data on loans. But small banks are exempt from these requirements, and the agencies do not presently collect data on CD investments or CD services. The Proposal contains data collection, recordkeeping and reporting requirements that would apply to banks. There would be separate requirements for banks subject to the general performance standards and for banks subject to small bank performance standards.

GENERAL PERFORMANCE STANDARDS

Banks subject to the general performance standards would need to collect and maintain performance standards data, including (1) retail lending distribution tests for the borrower distribution and geographic distribution tests for each major retail lending product line evaluated in the assessment area, (2) bank-level and each assessment-area-level CRA evaluation measures calculated under the regulation and (3) presumptive ratings. Banks would report this data to the agencies annually, along with the annual quantified value of qualifying retail loans, CD loans, CD investments and CD services as of the close of business on the last day of each month. Additionally, banks annually would have to report information on the number of home mortgage loans; consumer loans, by product line; small loans to businesses; small loans to farms; the average monthly value of retail domestic deposits; and assessment area information.

Banks would have to collect and maintain certain qualifying activities and retail domestic deposit data, including, for each qualifying loan (i) a unique number or alpha-numeric symbol to identify the relevant loan file; (ii) loan type; (iii) date of (as applicable) origination, purchase, or sale if the loan is a retail loan and sold by the bank within 90 days of origination; (iv) an indicator of whether the loan was originated or purchased; (v) loan amount at origination or purchase; (vi) outstanding dollar amount of the loan, as of the close of business on the last day of the month, for each month that the loan is on balance sheet; (vii) loan location and associated FIPS code for the MSA, state, county or county equivalent, and census tract; (viii) income or revenue of the borrower; and (ix) the qualifying activities criteria in the regulation that the loan satisfies or that it is on the illustrative list and whether it serves a particular assessment area, if applicable.

For non-qualifying home mortgage loans and consumer loan originations, a bank would collect and maintain a unique identification number or symbol, the loan type, the origination date, the loan amount at origination, the loan location and the income of the borrower.

Banks would be required to collect and maintain records of the number of all qualifying and non-qualifying retail loans at the census-tract level and report at the county or county equivalent level.

For each community development investment, a bank would be required to collect and maintain a unique identification number or similar mechanism, investment type, date of investment, outstanding dollar value of the investment as of the close of business on the last day of each month that the investment is on-balance sheet, the value of the monetary or in-kind donation, the investment location, and the qualifying criteria that the investment satisfies or that it is on the illustrative list and whether it serves a particular assessment area, if applicable.

A bank would be required to collect and maintain descriptions of each qualifying CD service and the date each CD service was performed. The value of each retail domestic deposit account and the physical address of each depositor as of the close of business on the last day of each quarter also would be collected and maintained. Banks also would be required to collect and maintain a certification from each party conducting qualifying activities where the bank is substantively conducting qualifying activities, but the activity is nominally done by another party, such as an affiliate.

For each assessment area, a bank would be required to collect and maintain a list of each county or county equivalent, metropolitan division, nonmetropolitan area, metropolitan statistical area and state within the assessment area. Banks would also be required to collect and maintain information indicating whether each facility operated by the bank during the evaluation period was a depository or non-depository facility.

Banks would be required to collect and maintain records of qualifying activities data at the bank level and for each assessment area. The Proposal describes how banks would determine the location of an activity.

SMALL BANK PERFORMANCE STANDARDS

Banks evaluated under the small bank performance standards would generally be exempt from the data collection, recordkeeping and reporting requirements of the Proposal, but small banks would be required to collect and maintain data on the value of each retail domestic deposit account and the physical address of each depositor as of the close of business on the last day of each quarter.

Strategic Plan

The Proposal retains the option for a bank to develop a strategic plan for addressing its CRA responsibilities and to be evaluated based upon its performance under the plan. A bank's strategic plan would be developed with public participation and would demonstrate how the bank would meet the credit needs of its assessment areas through qualifying activities.

Effective Date and Compliance Dates

The compliance and effective dates of the rule would be staggered such that the effective date would be at least two months after publication of the final rule. To reduce the compliance burden, however, the rule would include a transition period through various compliance dates, the earliest of which would be one year after the effective date. A bank would have one year to comply with the rule's assessment area, data collection and recordkeeping requirements and two years to comply with the reporting requirements. Small banks that opt into the general performance standards as of the rule's effective date or that no longer meet the definition of a small bank would be afforded additional time. Banks would not be evaluated under the new framework until they complete their evaluation period that concludes immediately after the reporting requirements compliance date.

Comment Period

The agencies invite comments on all aspects of the Proposal and pose numerous questions within it for consideration. Comments must be received by March 9, 2020.

For more information about the topics raised in this Legal Update, please contact either of the following lawyers.

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Endnotes

1 Interpreted broadly to include all lending, investment and service activities that are related to the CD qualifying activities criteria.

2 Small banks may opt in to the general performance standards. The Proposal amends the definition of "small bank" from less than $1.284 billion to $500 million or less (measured by assets in each of the previous four calendar quarters, adjusted annually for inflation). Small banks that choose not to opt in would continue to be evaluated according to the current small bank performance standards, unless they are evaluated under an approved strategic plan. A small bank that has opted in may exercise a *one-time* opt-out.

3 A major retail lending product line is one that comprises at least 15% of the bank-level dollar volume of total retail originations during the evaluation period.