The Interagency Community Reinvestment Act Proposal

Ten Things To Know

On May 5, 2022, the Board of Governors of the Federal Reserve System ("Board"), the Federal Deposit Insurance Corporation ("FDIC"), and the Office of the Comptroller of the Currency ("OCC") released a notice of proposed rulemaking ("NPR") to overhaul the agencies' regulatory framework for evaluating banks' Community Reinvestment Act ("CRA") performance. The NPR would make the most significant interagency changes to the agencies' CRA regulations in more than 25 years, and follows a 2020 advance notice of proposed rulemaking by the Board, as well as an effort by the OCC to make changes to its own CRA rules, which the OCC reversed last year. The deadline for comments on the NPR is August 5, 2022.

1 The NPR would establish three size categories based on a bank's total assets and impose the most stringent standards and requirements on banks with over $10 billion in assets.

The new framework would establish three size categories: (1) "large" banks with average assets of at least $2 billion in both of the prior two calendar years, (2) "intermediate" banks with average assets of at least $600 million for both of the past two calendar years but less than $2 billion in either calendar year, and (3) "small" banks with average assets of less than $600 million in either of two prior calendar years. These thresholds would be adjusted annually for inflation. The NPR would tailor the evaluation criteria and data requirements that apply to intermediate banks and, to an even greater extent, small banks.

In addition, the NPR would impose the most extensive evaluation criteria and data collection requirements on large banks with more than $10 billion in assets, as discussed below. The $10 billion threshold would not adjust annually for inflation.

The activities of a bank's operating subsidiary would be required to be attributed to the bank for CRA purposes. As under the current CRA rules, inclusion of other affiliates' activities would be at the bank's option.

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2 Four different performance tests could apply to a large bank, each with a substantial number of sub-tests and/or factors considered, and some of these tests would consider elements of performance that are not part of the existing CRA framework.

Under the NPR, a large bank with more than $10 billion in assets would generally be subject to four tests, including evaluation of a considerable number of quantitative and qualitative sub-tests and factors. The various performance tests and sub-tests could easily produce hundreds of scores, conclusions, and ratings of different facets of a bank's performance across various geographies.

The **Retail Lending Test** would evaluate whether the retail lending activities of the bank meet the needs of low- and moderate-income ("LMI") individuals, small businesses, and small farms, and individuals and businesses in LMI census tracts. Retail loans potentially subject to evaluation encompass six categories: (1) automobile; (2) closed-end home mortgage; (3) open-end home mortgage; (4) multifamily; (5) small business; and (6) small farm loans. The inclusion of automobile loans is notable because under the existing CRA regulations, automobile loans are not subject to evaluation unless consumer loans constitute a majority of the bank's business.

The test would begin with a ***retail lending volume screen*** that would assess a bank's volume of retail lending (including originations and purchases) relative to its deposit base in each facility-based assessment area. This ratio would need to be at least 30 percent of the market average ratio of large banks in the area for a bank to receive a "Satisfactory" rating in the area.

The test primarily would evaluate the distribution of a bank's retail loans in its assessment areas, and the geographies outside its assessment areas as a whole, across the retail lending categories that constitute ***"major product lines"*** for the bank within the area. "Major product lines" would generally be defined to include any of the six categories of retail loans that comprises 15 percent or more of the bank's total retail lending, by dollar amount, in that area.[1] The distribution of a bank's loans in major product lines in a given area would generally be evaluated across two dimensions: (1) a ***"geographic distribution" metric*** that would evaluate the bank's proportion of originated and purchased loans to borrowers located in LMI census tracts in the assessment area, and (2) a ***"borrower distribution" metric*** that would evaluate the bank's proportion of originated and purchased loans to LMI borrowers, small businesses, and small farms in the assessment area overall, regardless of geography. For both metrics, the bank's performance would be compared to (A) the comparable proportion reported by all reporting lenders in the assessment area in a ***"market benchmark"*** and (B) local demographics in a ***"community benchmark."***

The **Retail Services and Products Test** would predominantly use qualitative means, informed by quantitative metrics, to evaluate (a) a bank's delivery systems and (b) the responsiveness of its credit and deposit products.

The first Retail Services and Products sub-test, addressing the bank's ***delivery systems*****,** would consider (1) branch availability and services, (2) remote service facilities, and (3) digital and other delivery systems.

First, the ***branch availability and services*** evaluation would compare the distribution of a bank's branches in LMI census tracts to community benchmarks and market benchmarks, with examiners retaining discretion about how to use that data to produce a conclusion. Branches that are: (i) in or nearby census tracts that have low or very low access to bank branches; (ii) in middle- or upper-income census tracts that have been shown to serve LMI customers; (iii) in distressed or underserved nonmetropolitan middle-income census tracts; or (iv) in Native Land Areas would all be considered favorably. Examiners would also evaluate the bank's record of opening and closing branches in LMI census tracts. Additionally, the hours of operation and services offered at branches located in LMI census tracts would be compared to the hours and services offered at branches located elsewhere, with favorable consideration given to services that improve access or decrease costs for LMI individuals.

Second, the ***distribution of remote service facilities*** (including ATMs) in a given assessment area would be compared to community benchmarks (*i.e.*, income demographic information).

[1] Automobile loans would be a major product line in an area if they comprised 15 percent of the bank's total retail lending, measured as average of the dollar percentage and loan count percentage, in the area.

The proposed focus on remote service facilities is notable because the placement of these facilities has not previously been subject to evaluation.

Third, ***digital and other delivery systems*** would be evaluated at the institution level based on (i) digital activity by individuals in LMI census tracts compared to that of middle- and upper-census tracts, including usage and account openings, (ii) the range of digital and other delivery systems that the bank offers, and (iii) the bank's strategy and initiatives to serve LMI individuals through such systems. This review would also introduce new elements to CRA evaluations by considering the rates of usage of mobile apps and other digital platforms by customers in different income categories.

The second overall Retail Services and Products sub-test would look at the ***responsiveness of the bank's credit and deposit products***. For credit products, a bank's products and programs offered to LMI individuals and small businesses and small farms would be considered on a qualitative basis. Products such as small dollar mortgages, consumer loans that use alternative credit histories, and microloans would receive favorable consideration. For deposit products, examiners would consider the availability and usage of deposit products responsive to LMI individuals' needs. To evaluate availability, examiners would consider the extent to which a bank offers: (i) deposit products with low-cost features, such as no overdraft or insufficient funds (NSF) fees, no or low minimum balance requirements, no or low monthly maintenance fees, and free or low-cost checking and bill payment services; and (ii) features that facilitate broad functionality and accessibility, such as in-network ATM access, debit cards for point of sale and bill payments, and immediate access to funds for customers cashing payroll, government, or bank-issued checks and features that facilitate inclusive access by people with adverse credit or banking histories. To evaluate usage, examiners would consider the number of accounts opened and closed by LMI individuals compared to middle- and upper-income individuals; the percentage of the bank's total responsive deposit accounts compared to its total deposit accounts; and marketing, partnerships, and other activities by the bank to promote awareness and use.

The **Community Development Financing Test** would evaluate whether a bank meets community development financing needs in its assessment areas and institution-wide through community development loans and community development investments (known in the existing CRA regulations as "qualifying investments"). This test would focus on a community development financing metric that would be calculated as the ratio of the bank's community development loans and investments to deposits, and also would involve a qualitative review of the impact of these loans and investments.

A qualitative conclusion would be assigned at the assessment area level (which would also be translated to a numerical performance score) based on a comparison of a bank assessment area community development financing metric, which would consider the bank's own community development financing relative to deposits, against (1) a similar metric looking at all large banks in the assessment area and (2) another similar metric for all large banks in either all nationwide metropolitan or nonmetropolitan areas, as appropriate. The agency would also conduct a review of the impact and responsiveness of the relevant activities in the facility-based assessment area referencing, though not limiting, review to a designated list of impact review factors.

The institution-level score for this test would consider the assessment area conclusions and nationwide conclusion, the latter designed to consider community development financing beyond the assessment areas, in shifting ratios depending on the average percentage of the institution's retail loans and deposits actually linked to the assessment area.

The **Community Development Services Test** would review the extent to which a bank provides community development services and the impact of those services in satisfying community development needs.

One element of evaluation would be the review of the ***provision of community development services***. This review might consider review of information such as: (i) the total community development services hours; (ii) the number and type of community development services; (iii) (for nonmetropolitan areas) the number of activities related to financial services; (iv) the number and proportion of community service hours completed by the executive employees and other employees of the bank; (v) the extent to which the community development services are used; and (vi) other evidence that the services benefit LMI individuals or otherwise respond to community needs.

A second element of evaluation would be the ***community development service hours metric***, a measure of the average number of community development service hours per full time equivalent employee of the bank in the facility-based assessment area.

A third element of evaluation would be the evaluation of ***impact and responsiveness of the community development services***.

The four tests described above would combine to a single overall institution-level performance score,[2] with a weighting of 45 percent for the Retail Lending Test, 15 percent for the Retail Services and Products Test, 30 percent for the Community Development Financing Test, and 10 percent for the Community Development Services Test. Evidence of discriminatory or other illegal practices (discussed in more detail below) and a bank's past performance would also be considered in evaluating the bank's performance. Finally, the agency would assign the bank an overall, institution-level descriptive rating of "Outstanding," "Satisfactory," "Needs to Improve," or "Substantial Noncompliance."

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3 The NPR would, for the first time, require evaluation of a large bank's retail lending performance in "retail lending assessment areas" where it has concentrations of retail loans, as well as evaluation of its retail lending and community development financing across geographies that are not designated as assessment areas.

A large bank would be required to delineate two types of assessment areas in which its CRA evaluation would generally be focused:

- A "***facility-based assessment area***" would generally be the same as an assessment area under the existing CRA regulations, except that the minimum size would be at the county level. Facility-based assessment areas would thus be defined to encompass any county where the bank has a main office, branch, or other staffed or remote deposit-taking facility, as well as surrounding geographies in which the bank has originated or purchased a substantial portion of loans.
- A *"**retail lending assessment area**"* would include any (1) metropolitan statistical area (MSA), excluding counties already included within a facility-based assessment area or (2) aggregation of all the nonmetropolitan areas in a single state, excluding counties already in a facility-based assessment area, in which the bank made at least 100 home mortgage originations or 250 small business lending originations for two consecutive calendar years.

[2] State- and multistate MSA-level ratings are required to be assigned under the statute but would not directly affect a bank's institution-level CRA rating under the NPR.

Notably, in its 2020 advance notice of proposed rulemaking, the Federal Reserve stated that it would be inclined to require lending-based assessment areas only for internet banks that do not have physical locations and banks that partner with online lenders that do not have physical loan-making locations. The NPR instead proposes that retail lending assessment areas would apply to all large banks.

The NPR's Retail Lending Test would also include evaluation of a bank's retail lending distribution in an "***outside retail lending area***," meaning the nationwide area outside of a bank's facility-based assessment areas or retail lending assessment areas.

However, the NPR's broadening of the geographic focus of CRA evaluations could also create opportunities for banks. Under the proposed Community Development Financing Test and Community Development Services Test, banks would have a clear means to obtain CRA credit for community development activities performed anywhere in the country, in contrast to the existing CRA regulations, which only provide credit for activities outside a bank's assessment areas if the bank has adequately addressed the needs of its assessment areas.

While assessment areas would still shape the performance evaluation, activities across multiple geographies would generally be weighted in order to produce ratings at the institution-level, which would somewhat deemphasize the importance of performance in assessment areas (especially less significant assessment areas) to a bank's overall CRA rating. The NPR would include some constraints on this principle to ensure a continued focus on assessment areas, such as a requirement that a bank with at least 10 assessment areas receive a "Satisfactory" overall rating in at least 60 percent of its assessment areas to receive a "Satisfactory" institution-level rating.

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4 The NPR would clarify, and in some cases expand or narrow, the activities that receive credit as community development activities.

The NPR proposes the establishment and maintenance of a public non-exhaustive, illustrative list of qualifying community development activities to guide banks. The NPR would also set forth 11 community development purposes that would warrant credit under the two Community Development tests. An activity generally would be required to be performed with a "primary purpose" of promoting one or more of these community development goals to count, though some activities relating to affordable housing could receive partial credit if the relevant project supports non-affordable housing as well.

The NPR would provide more clarity that some activities not previously counted as community development would count, or clarify the circumstances in which activities would count. Notable activities that would qualify as community development under the NPR would include:

- Activities supporting naturally occurring affordable housing;
- Activities supporting disaster preparedness and climate resiliency in LMI census tracts and other targeted areas;
- Financial literacy initiatives (at any income level);
- Activities in Native Lands Areas;
- Activities performed in partnership with minority depository institutions (MDIs), women depository institutions (WDIs), and community development financial institutions (CDFIs);

- Activities supporting affordable housing where less than a majority of units are affordable (which would receive pro rata credit);
- Investments in mortgage backed securities when the security contains a majority of either single-family home mortgage loans for LMI individuals or loans financing multifamily affordable housing; and
- Community development services, which would include not just financial-related services but also activities performed by a bank's HR, IT, and Legal functions, and in nonmetropolitan activities would include all volunteer activities that meet an identified community development need.

The NPR would also remove the existing requirement that activities supporting economic development demonstrate job creation, retention, or improvement for LMI individuals or areas. However, small business loans that previously counted as economic development would be evaluated under the Retail Lending Test rather than the Community Development Financing Test.

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5 The NPR would impose significant new data collection requirements on large banks, particularly those with more than $10 billion in assets.

The NPR would require large banks to collect voluminous data concerning deposits, retail loans, and community development activities, which would be used to evaluate their performance in the quantitative parts of the NPR's four tests. A large bank with more than $10 billion in assets would be required to collect the most granular data, including the county of each depositor, which would determine the bank's deposit base in each assessment area and thereby influence the bank's CRA obligation in each assessment area. Other large banks could would not have the obligation to collect the county of each depositor, and the agencies would instead look to the FDIC's existing Summary of Deposits data, which report the branches in which banks books their deposits, to determine these banks' CRA obligations.

While strategic plan banks with more than $10 billion in assets would be subject to the same data collection requirements as other similarly-sized banks, wholesale and limited purpose banks would be excluded from certain key data collection requirements, including the requirement to collect data on deposits, retail services, and community development services.

Intermediate banks and small banks would not be subject to additional data collecting or reporting requirements compared with current regulations, unless in some cases they choose to be evaluated under optional tests.

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6 The wholesale or limited purpose designation would remain an option; wholesale and limited purpose banks would be subject to evaluation based on their community development financing activities with optional consideration of community development services.

The definitions of wholesale bank and limited purpose bank would remain substantially the same as in the existing CRA regulations.

Wholesale and limited purpose banks would be subject to a tailored version of the Community Development Financing Test, which would include a metric evaluating the volume of the bank's community development lending and investment activities at the assessment area level and institution level. For wholesale and limited purpose banks, the denominator of this metric would be the bank's total assets. These banks would also have the option to have their community development service activities evaluated as if they were subject to the Community Development Services Test.

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7 Strategic plans would remain an option, but could be more challenging to implement than in the current rules.

Under the NPR, a bank could still opt to be evaluated under a strategic plan in lieu of the size-based tests. However, the bank would be required to incorporate standards and metrics from its size group to the extent appropriate, unless the bank is substantially engaged in activities outside the scope of those tests. If the bank set goals different from the standard, it would need to explain the appropriateness of such goals.

A strategic plan bank would need to delineate facility-based and retail lending assessment areas just as it would under the standard tests, with the additional possibility for consideration of retail lending and community development financing outside such areas. The strategic plan bank would also need to set measurable goals for helping to meet the retail lending needs, retail services and products needs, community development financing needs, and community development services needs of various geographies that would otherwise be evaluated in the absence of a plan, as well as measurable goals for each retail lending major product line.

The NPR would require a strategic plan bank to demonstrate its community engagement during the drafting of the plan. For example, the bank would be expected to provide information regarding which community stakeholders it had consulted, the efforts it made to publicize the process, and the methods it used to engage stakeholders.

The strategic plan provisions of the NPR would be effective one year after the effective date of a final rule. Plans submitted for regulatory approval prior to that date could follow the requirements of the existing CRA rule, and would remain valid until their expiration.

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8 The NPR would broaden the circumstances in which the agencies could seek to downgrade a bank's CRA rating based on a compliance violation.

Under the existing CRA regulations, the agencies may downgrade a bank's institution-level CRA rating due to evidence of discrimination or other illegal *credit* practices. The NPR would revise this standard to extend beyond credit to *any* discriminatory or illegal practice. This change appears intended to capture illegal practices relating to non-credit consumer banking products, such as evidence of discrimination in the offering of deposits, which the Consumer Financial Protection Bureau has recently asserted would constitute an unfair act or practice. However, the proposed rule text's reference to "illegal practice" would potentially reach more broadly.

Additionally, while the agencies currently consider the corrective actions that a bank has taken in determining whether to issue a downgrade, new criteria set forth in the NPR would not expressly include consideration of the bank's remedial actions. The proposal also would permit a downgrade at the state and multistate MSA level in addition to an institution-level downgrade.

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9 The NPR would tailor requirements for banks with up to $10 billion in assets.

Under the NPR, expectations and requirements would differ for (1) a large bank with over $10 billion in assets, (2) a large bank with no more than $10 billion in assets, (3) an intermediate bank, and (4) a small bank:

- A large bank with no more than $10 billion in assets would be subject to all of the four tests that would apply to large banks with more than $10 billion in assets, but would be subject to fewer sub-tests. Specifically, the Retail Services and Products Test would not include evaluation of the bank's digital and delivery systems or the responsiveness of its deposit products to LMI individuals, and the Community Development Services Test would not include a quantitative measurement of the bank's service hours.
- An intermediate bank would be subject to the Retail Lending Test and either the community development performance standards currently applicable to intermediate small banks in the existing CRA regulations or, at the bank's option, the new Community Development Financing Test. An intermediate bank could also opt in to having its community development services evaluated.
- A small bank would be subject either to the current small bank lending test set forth in the existing CRA regulations or, at the bank's option, to the new Retail Lending Test.

As noted above, intermediate banks and small banks would not be subject to new data collection or reporting requirements compared to the existing CRA regulations, unless in some cases they choose to be evaluated under optional tests.

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10 The rule would provide a transition period of no more than a year for most of its key requirements.

The final rule would become effective the first day of the first calendar quarter beginning at least 60 days after its publication in the Federal Register, and would include a relatively brief transition period thereafter for its key requirements to become applicable.

Data collection requirements would become applicable 12 months after the final rule publication, with annual reporting beginning by April 1st of the year following the first year of data collection. Banks would become subject to the new tests on the same timeframe. Specifically, CRA examinations under the new tests would begin two years after the publication of the final rule, evaluating activities conducted during the prior year. The preamble to the NPR notes that modified procedures would apply for examinations immediately after the start date until the peer data and relevant benchmarks become available.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our Financial Services practice:

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