CRA Regulatory Rewrite

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Impact Assessment

- The new CRA standards are very complex, yet in several ways also subjective. This undermines the ratings consistency agencies seek but also affords more opportunity for banks with unusual business models or innovative community-service programs.
- In general, earning high CRA ratings will prove more difficult, complicating expansion plans and likely increasing bank services and credit for under-served communities.
- The cost of doing CRA-eligible business may rise, adversely affecting bank competitiveness vis-à-vis credit unions and nonbanks. Nonbank mortgage-origination marketshare may increase due to these costs and shifts in bank mortgage strategy.
- New assessment areas are likely to better capture fintech-focused banking charters and mobile-delivery markets, reducing CRA-driven incentives to concentrate LMI-focused activities only where a bank has physical facilities.
- Activities eligible for CRA consideration would be more tightly defined to make eligible only activities directly and demonstrably germane to LMI households (e.g., "responsive" digital-service delivery or deposit-taking). Extensive data and record-keeping requirements would apply.
- Mortgage lending would be less important to CRA ratings, with small-business and -farm lending and that related to automobiles taking new importance along with an expanded range of community-service and -development activities.
- Otherwise-eligible single- and multi-family mortgages originated for the GSEs would count for CRA, but MBS would need to have a clear link to affordable housing to be qualified investments.
- Deposit-taking activities now factor into CRA ratings, expressly rewarding bank activities such as BankOn product offerings and increasing incentives for financial inclusion despite the complexities of how CRA credit would be calculated under the NPR.

- New race/ethnicity demographic data regarding mortgages would be reflected in determinations of whether banks engage in discrimination for CRA-rating purposes in ways that could lead to fair-lending enforcement and/or reputational challenges.
- CRA review would be more transparent, increasing the influence of lobal and national groups over bank strategy and enhancing industry responsiveness along with CRA-related costs and reputational risk.

Overview

Following much talk about the need to update Community Reinvestment Act (CRA) rules since this was last done in 1995, federal banking agencies have finally agreed on a proposed redesign of standards essential to banks that wish to expand or acquire as well as those seeking strong community ties and the policy and political benefit these afford. Much of the complexity in the NPR results from the agencies' decision to allow only partial credit for activities (e.g., mortgages) largely assumed in the past to benefit low-and-moderate income (LMI) households if they occurred in LMI census tracts as well as to condition product approval on the extent to which LMI-household needs are demonstrably met. Offsetting these restrictions to some extent are broader criteria for eligible community-development and -service activities, but only wholesale and limited-purpose banks will enjoy the full benefit because new weightings require regulators to give the most weight to retail finance at most large banks.

The new standards would also be very complex and require extensive operational and compliance build-out. They would also increase the transparency of CRA criteria and bank performance, rewarding institutions with significant commitments but also raising the bar for M&A and branch approvals.

Impact

This proposal follows much discussion and then opposition to the OCC's CRA rewrite during the Trump Administration[1] and the Federal Reserve's indirect response via an advance notice of proposed rulemaking that took a very different approach to issues such as CRA eligibility and environmental justice.[2] The new approach also strongly reflects a shift in political sentiment since the 2020 election and the Biden Administration's strong determination to advance economic equality and racial equity in concert with more stringent standards governing bank mergers.[3]

CRA rules have not been comprehensively updated on an inter-agency basis in more than twenty years. Over this period, banking has changed dramatically in the wake of digital innovation, mergers, nonbank competition, and a greater awareness of what has come to be called the structural racism that has often denied majority-minority communities and persons of color with equitable access

[1] See *Client Report* **CRA28**, May 26, 2020.

[2] See **CRA30,** *Financial Services Management,* October 13, 2020.

[3] See *Client Report* **MERGER6**, July 9, 2021.

to credit and other essential financial services. Intervening years have also seen far greater awareness of climate risk and its overall implications for community development, especially in LMI and minority areas often at greater risk of natural disasters or industrial hazard.

As discussed below, the NPR lays out a new approach to CRA designed to reflect these Biden Administration priorities along with industry transformation. While the original rules assumed that most products offered to LMI households were "democratizing" finance, the proposal takes a considerably more skeptical approach and thus demands an array of often- complex eligibility standards for the amount of an obligation considered CRA-eligible, the terms and conditions on which it is offered, and the customers or areas being served. This is intended to prevent CRA-eligible activities and obligations from supporting gentrification, creating incentives for LMI or minority financial inclusion, and increasing the social-welfare obligations for institutions governed by the Act. Regulators such as CFPB Director Chopra believe that nonbanks with indirect access to these benefits should also come under the CRA, but legislation to mandate this has long been stalled.

The exception to the more limited definition of CRA-eligible activities or exposures defines investments considered community development. The proposal codifies some activities (e.g., disaster recovery) allowed under prior inter-agency guidance and expands the list to include recent concerns such as environmental resilience. This could make it easier for at least some large banks to score well, but the proposal restricts consideration only when the majority of project beneficiaries are LMI households or certain other conditions are met.

Affordable-housing (now more tightly defined) would be judged proportionately – i.e., the percentage of the obligation equivalent to that directed to or used by LMI households would be eligible instead of eligibility for the entire balance if the area served is an eligible LMI assessment area or project design is targeted at affordable housing. Failing to adopt this partial-credit approach and instead demanding complete LMI-household commitment for other community-development activities (e.g., health care) could make it more difficult for banks to participate in such projects, but the agencies fear that proportionate treatment might undermine the credibility of the CRA system. Industry comment may note the challenges to establishing affordable-housing eligible for CRA credit to argue not only for more generous treatment in that sector, but also like-kind eligible for non-housing projects often considered essential to social welfare.

One major goal of this CRA proposal and those that came before is redefining assessment areas to reflect the growing use of digital-delivery systems. The proposal does not abandon the facility-based approach to assessment areas, but it gives large banks greater flexibility to set assessment areas to reflect retail-lending activities or the needs of broader geographic regions in which they also have a facility-based area. However, many restrictions apply to the manner in which assessment areas without physical facilities are judged, essentially demanding a national footprint for the largest banks that may raise the cost of doing business in areas where the number of mortgages or small-business loans may seem large for the market but is very small for the bank.

Another key part of the proposal is a tougher approach to evaluating and grading banks. Among other changes, the largest banks (set here as those with assets over $10 billion) would need to gather deposit data by their assessment areas giving the agencies "volume" data against which to judge the extent to which lending is proportionate to deposit-taking. Current data are generally branch-based, with this new methodology likely leading to considerable differences between performance judged under current assessment areas and those under the new, broader standards. Complex distribution metrics designed to ensure that lower-income populations and the bank's entire market are well served are also detailed.

One aspect of these distribution metrics judges not only branch locations, but also the services offered at these branches to determine the extent to which a bank branch ensures truly equitable service availability. Considerations here are the "reasonableness" of branch hours, the range of service offerings, translation and check-cashing service availability, and "reasonably-priced" remittance services. The overall "responsiveness" of deposit products judged by criteria outlined in the rule would also be considered. As a result, just because an LMI or majority-minority community has a bank branch no longer ensures that a physical presence is credited for CRA purposes despite the strong view by community advocates that "banking deserts" without branches adversely affect economic equality. Steps a bank may take to retain a branch that do not meet the reasonableness standards may undermine profitability and lead banks simply to close these branches.

Performance-context and qualitative factors would also be considered before a CRA rating is granted. These two factors are subjective, perhaps reducing the consistency the agencies anticipate from the quantitative metrics and posing challenges or opportunities to banks in unusual markets or with unusual business strategies. All of the key factors going into setting a CRA rating will be judged not only at each assessment area, but also on an institution-wide, aggregate basis. Examiner judgment would figure heavily into these determinations.

In the past, community advocates who argued that banks got undue CRA credit related to affordable housing, recommending that loans or MBS associated with the GSEs or Ginnie Mae not be eligible because banks effectively took no risk. The proposal would adopt a tighter approach to government-program credit than in current rules by requiring that it have a bona fide intent of providing LMI-focused affordable housing, but it still does not generally change current standards. It does, though, seeks comment on whether, for example, MBS should count only if they are significantly focused on LMI households or otherwise-eligible purposes.[4]

Community advocates also often believe that the current approach to CRA allows banks to gain undue credit for residential or multifamily mortgages that benefit upper-income households in gentrifying or diverse census assessment areas. The complex new approach to assessment areas thus would not only

[4] See **GSE-120919**, *GSE Activity Reports*, December 9, 2019.

capture digital delivery, but also home in on geographic areas to refine them into more discrete areas which regulators believe would enhance bank accountability. This would also be accomplished, they hope, via a new approach to the retail-lending test for larger banks; among other things, this would require banks to differentiate retail products, including segmenting mortgage products. This would not only make mortgage lending less important in the overall scheme of CRA evaluations, but also make it more difficult for banks to get mortgage credit for other products (e.g., HELOCs) or even refis that now may be disproportionately available only to white or more affluent households.[5] The agencies believe product segmentation will also allow them to spot purchase-loan shortfalls during periods of high refi volume.

Another major change related to large bank retail lending is the proposed capture of auto lending as a separate form of consumer credit, with all other types of consumer credit (e.g., credit card) lumped into the consumer category. This would capture new (but apparently not also used) car loans related to personal use in order to reflect the importance of auto lending to job transport and other needs the agencies believe are particularly acute in LMI areas. Given the importance of CRA ratings and the changing role of mortgage finance, these new auto-lending standards could encourage more direct auto lending, especially for lower-priced cars.

Another important change in the proposal would credit banks for certain types of deposit-taking. The law itself is premised on the view that banks which take deposits in under-served neighborhoods do so thanks to federal benefits that warrant restricting these privileges at least to some extent to banks that use deposits to make loans in the areas from which deposits are gathered. This is also intended to reduce redlining and thus enhance racial and ethnic equity. However, the decades of recognizing only lending and community-development investments created incentives for banks to abandon deposit-taking in some neighborhoods, doing so more frequently as digital-service delivery minimized the need for physical facilities which, as noted, are often of particular importance in lower-income communities. Recognizing deposit-taking that meets these needs creates a new incentive to retain not only a physical presence, but also to enhance digital delivery of deposit-taking services to make them better suited to lower-income households with unique needs in areas such as remittances.

The analysis below only scratches the surface of the metrics the agencies propose to judge large-bank retail lending and the data on assessment areas, products, investments, and customers that would be required of all larger banks regardless of business model. These will require extensive new data-gathering, monitoring, validation, and governance systems and in some cases possibly lead to public disclosure of proprietary marketing or business information. The agencies hope that metrics increase CRA-evaluation consistency across banks and regions, but the complexity of the new requirements combined with the authority of examiners to override metrics-based conclusions on qualitative grounds may adversely affect this consistency.

[5] See **GSE-111821**, *GSE Activity Reports*, November 11, 2021.

What's Next

This proposal was released by unanimous agreement at an FDIC meeting on May 5.[6] Comments are due by August 5, a full ninety days after release but considerably less time than might have been the case if the comment deadline was tied to *Federal Register* publication. This is often very delayed for large rules and – this proposal is 679 pages long. As a result, awaiting publication would likely have pushed publication well into the fall, making it very difficult to issue a final rule in 2022. This not only slows the update sought by many industry and community groups, but also exposes the final rule to Congressional repeal should Republicans gain Congressional control in 2023.

The proposal affords an intricate phased in transition to its final framework, making the rule effective on the first quarter sixty days after publication but giving banks a considerable period of time to implement the new approach based on the agencies' view of the challenges posed by specific requirements. During the transition period, CRA provisions not yet replaced by new ones would remain in effect, with the complexity of the new approach and its interaction with current rules leading to a complicated set of deadlines based on the section of the rule and a bank's size.

Analysis

As noted, this is a lengthy, complex proposal; the analysis below thus highlights strategic considerations, not implementation or compliance concerns unless these are also strategic. We also do not detail the 180 questions posed by regulators except where these could lead to significant strategic impact in the final rule not also evident in the proposal. The discussion below also generally focuses on large banks because these are defined as those with over $2 billion in assets and thus comprise the majority of insured depository institutions and holding companies. Small banks may also elect to stay under current rules.

I. Evaluation Framework

A. Community and Development Service Test

1. Eligible Activities

The NPR includes both a list of activities and a non-exhaustive, illustrative, non-binding set of examples of eligible activities within this test. Banks could also seek prior approval for those not clearly encompassed in either the rule or list. However, to be eligible, the purpose of the activity would need to fit within the categories noted below and be its express, primary purpose, with the NPR clarifying how this is determined to end the practice of obtaining credit for projects that, while having some community benefits, were nonetheless largely commercial in scope and purpose. Activities included in the NPR's general community-service framework include:

6 See *Client Report* **CRA31**, May 5, 2022.

- affordable housing, which is more tightly defined and for which a prorated formula applies to ensure that credit is only received for housing that is specifically aimed at under-served residents. Activities that promote affordable home ownership (e.g., downpayment assistance) also qualify under certain conditions;
- economic development aimed at small businesses and small farms (both of which are defined in the rule in an effort to target entities that would previously have been considered very small);
- community-supportive services (e.g., child or health care, job development, education);
- revitalization activities, with these significantly altered from the current list to capture more expansively disaster preparedness, climate resilience, and post-disaster recovery. These are generally still limited to affected places, with comment sought on whether eligible services (e.g., disaster preparedness) should be counted for LMI households regardless of specific, known hazards;
- essential community facilities or infrastructure;
- MDI, WDI, low-income credit union, and CDFI activities;
- financial literacy; and
- eligible activities on tribal land.

Direct lending to projects eligible for community-development credit is also usually eligible for CRA recognition, with the agencies so far deciding against additional tightening (e.g., mandating minimum holding periods for MBS investments or ongoing analysis of rent affordability).

2. Impact Review

The agencies plan also to conduct a review of community-development activities under this test as well as the community-development financing test on its own and as applied to wholesale or limited-purpose banks, which are judged on a largely qualitative basis. The goal here is to standardize decisions as much as possible on new activities.

B. Retail-Lending

All lending for small businesses and small farms would come only under this test, not that for community service regardless of the loan's economic-development purpose, with definitions here transitioning to those used by the CFPB for small businesses and farms once data on them has been gathered following final action on the agency's fair-lending reporting rule.[7] The agencies believe that this approach "in some ways" is more generous than the current standard, performance under this test (see below) will be differently and stringently judged, especially for banks with assets over $10 billion.

[7] See **SBA40**, Financial Services Management, September 8, 2021.

C. Wholesale and Limited-Purpose Banks

Only a modified version of the community-development financing test would apply to these banks, retaining much of the current, qualitative approach but adding a quantitative metric at the institution level to enhance consistency. Community-development service could also be considered at the bank's request if the bank's performance is otherwise satisfactory.

II. CRA Performance Assessment

A. Assessment Areas

Nothing about assessment-area designation could be discriminatory, with the agencies noting their intent to coordinate CRA and fair-lending examinations to the greatest extent possible. As discussed below, the proposal also mandates new demographic data related to mortgage lending intended to enhance the coordination between these policy objectives and increase bank accountability for fair lending within each assessment area.

Large banks would set assessment areas based on physical facilities generally open to the public (although these need not take deposits). These facilities would also be defined to reflect new forms of deposit-taking via remote-service delivery. The large-bank retail-lending test is also based on where the bank makes designated numbers of home-mortgage and small-business loans outside its facility-based assessment areas. The agencies premise this on the view that it is appropriate to judge retail lending by local performance, although the proposal also allows for aggregate-performance evaluation under the retail-lending test to capture remote-service delivery. In practice, the new retail-lending thresholds are likely to make the entire nation sorted by individual geographic areas the assessment area for the largest banks. This may present compliance and reputation challenges where a bank has little to no presence outside the mortgage originations gathered via remote channels that would turn a census tract or broader area into an assessment area.

Assessment-area delineation would be more flexible in order to improve fair lending and LMI-service delivery. Community-development would not only be judged within facility-based assessment areas, but also outside them to “inform" examination conclusions.

B. Performance Tests

The NPR lays out metrics for judging performance that increase in complexity by bank size. Although large banks are generally considered those with over $2 billion in assets, the proposal also segments those with over $10 billion for performance standards for "major products" including deposit-taking and automobile-lending activities. These and other products are defined and the criteria for how they are factored into the retail-lending test are detailed in the NPR, going well beyond the lack of any product specifics in current rules. Major products are judged by percentages of total retail loans rather than by dollar or loan numbers.

The new approach also differentiates each type of mortgage lending for separate consideration. The large-bank retail-lending test and that germane to community development for banks over $10 billion would also rely on a set of specific metrics and community and market benchmarks detailed in the NPR designed in part to prevent "loan churning" (i.e., repeat sales of the same loan among banks ahead of each bank's CRA review) along with "other factors" and, for community development, qualitative criteria.

C. Strategic-Plan Option

The NPR retains the current approach of allowing banks to be evaluated under their strategic plans, but strategic plans would now need to incorporate metrics akin to those demanded of other banks. Large banks would also need to delineate relevant assessment areas.

D. Affiliates

Banks now may generally not include affiliate activity in their performance presentation, nor may affiliates claim loan originations or purchase claims from other affiliates. However, a bank may claim a loan by an affiliate also claimed by the affiliate for CRA purposes and these transactions for CRA credit may also be reversed as long as this is not done too often for the same obligation. Further, a bank that claims loans (e.g., LMI mortgages) from an affiliate must count all mortgages made by the affiliate to prevent distortions. The agencies now propose to require presentation of operating-subsidiary data (with comment sought on how to define these entities) and continue flexibility with regard to whether or not the activities of other affiliates are included by the bank. However, comment is sought on whether, if affiliates are counted, banks would have to count all loans in all assessment areas made by all affiliates germane to retail lending. Any illegal practice – not just discrimination – by an affiliate could also count against the bank.

E. Performance Context

The agencies also propose now to consider the context in which CRA activities occur – e.g., the bank's strategy, community needs, the bank's constraints. Numerous benchmarks and metrics for capturing community need and opportunities are also proposed. Work is also under way to determine how best to provide this context information to banks and the public.

F. Ratings

The agencies will assign conclusions for each performance test at each applicable assessment area, continuing the current grading system: outstanding, high satisfactory, low satisfactory, needs to improve, and substantial non-compliance. However, these ratings will now be set on the individual performance results at each assessment and test level, leading to scores that will then be released on bank performance in state, locality, and similar areas. Performance under each test will be weighted, with the largest weight assigned to retail lending now without regard also to community-development lending. The NPR also spells out how consumer-protection violations and remediation would be considered in adjusting ratings, laying out an array of criteria that could lead to downgrades at various levels of subordinate ratings or that of the bank as a whole.

III. Data Collection, Disclosure, and Reporting Requirements

A. Overall Standards

New data requirements would apply for all the new factors briefly outlined above. Taken together, all of these requirements would significantly increase bank transparency as well as the burden on large banks to gather many types of data, especially regarding operating subsidiaries, deposits, and the user characteristics that make digital delivery "responsive," not now required for internal purposes or under any other external standard.

The agencies also propose to make public CRA files more accessible and increase the opportunities for public comment on bank performance. Comment is sought on whether the agencies should, for example, publish aspects of a bank's data file ahead of a CRA evaluation to gather additional public input.

B. Demographic Data

CRA evaluations regarding mortgages now use HMDA data only to assess performance based on borrower income. Even though racial and ethnicity data are disclosed in public HMDA reports on an aggregate basis, the agencies propose distribution to gather new data on the by race and ethnicity of large-bank mortgage borrowers in each facility-based and retail-lending assessment area. These disclosures would include the number and percentage of these demographics compared against the assessment area's aggregate mortgage lending by all lenders in the area. These data are said not to have any direct impact on the bank's CRA ratings or its fair-lending evaluation unless the data lead the agencies to conclude that discrimination has occurred. Comment is sought on this proposal.