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Community Reinvestment Act Modernization:

A Threat to Low- to Moderate-Income Communities

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Executive Summary

The intent of this Capstone Project is to: summarize the key areas for changes to the Community Reinvestment Act (CRA) as proposed by the U.S. Department of the Treasury and the federal financial regulatory agencies; illustrate that these changes can potentially threaten the financial stability and community revitalization of low- to moderate-income communities; and provide recommendations on the necessary steps that must be taken before any changes to the CRA can be made. The CRA is a landmark civil rights statute passed to combat the legacy of discriminatory lending practices against lower-income borrowers and minority populations. The CRA provides an incentive for banks to reinvest in the communities where they are located and it has become an important tool to encourage bank lending, investment, and financial services in underserved communities.

The U.S banking industry has evolved since the enactment of the CRA statute including the advancement of mobile and internet banking and other technology innovations. As a result of these innovations, the financial regulatory agencies and financial institutions have sought to modernize the CRA to reflect current banking practices and digital economy. It is sensible to consider modernizing the regulation to align with current innovations in the financial services industry but changes in the CRA could have an adverse impact on the communities that it was designed to protect.

In January 2020, two of the three federal banking regulatory agencies issued a Joint Notice of Proposed Rulemaking with the purpose of strengthening and modernizing the CRA and sought public comment on these proposed changes. The two agencies proposed to make changes in key areas by: (1) Clarifying and expanding what qualifies for CRA credit; (2) expanding where CRA activity counts; (3) providing an objective method to measure CRA activity; and (4) revising data collection, recordkeeping, and reporting. The regulatory agencies received a large volume of comments both in support and opposition to the proposed changes. The findings outlined in this paper support the principle that the proposed changes to the CRA may encourage banks to reduce CRA-eligible activities, resulting in the reduction of financial services and community development primarily in underserved communities. Historical analysis reveal that when CRA-eligibility is removed, mortgage applications and originations decline significantly as banks are not incentivized to conduct business in LMI communities. The recommendations outlined in this paper provide the preliminary steps that the regulatory agencies must take first in order to consider modernizing the CRA to ensure that the statute continues to build upon its unparalleled legacy of expanding access to financial products and services to the LMI communities. Without CRA, many LMI communities will lack access to capital and revitalization efforts will not occur in these communities. The weakening of CRA will be detrimental to the efforts of closing the wealth gap and supporting stabilization in LMI communities.

Part I: Statement of Problem/Hypothesis

The CRA has played an instrumental role in promoting the vitality of underserved communities by encouraging investment, lending, and other banking activities that promote economic opportunity and community development. Enacted in 1977, the CRA requires depository institutions to meet the credit and deposit needs of communities that they serve, including low- and moderate-income (LMI) communities, consistent with safe and sound practices.[1] Specifically, in passing the CRA, Congress established that (1) regulated financial institutions are required by law to demonstrate that their deposit facilities serve the convenience and needs of the communities in which they are chartered to do business; (2) the convenience and needs of communities include the need for credit services as well as deposit services; and (3) banks have a continuing and affirmative obligation to help meet the needs of the local communities in which they are chartered.

Several laws were enacted in the 1960s and 1970s to address fairness and access to housing and credit for individuals located in vulnerable communities. During this period, Congress passed the Fair Housing Act in 1968 to prohibit discrimination in renting and buying a home, and the Equal Credit Opportunity Act in 1974 to prohibit creditors from discriminating against applicants on the basis of race, color, religion, national origin, sex, marital status, or age. These laws prohibited discrimination in lending to individuals primarily on the basis of racial composition; however, they did not prohibit excluding entire neighborhoods or regions on the basis of geographical factors. This shortfall created a backdoor for the government and banks to

[1] Under the CRA, the term low- and moderate-income refers to communities in certain geographies that have income levels that fall between certain ranges, as determined by the Census Bureau. A low-income community means there is a median family income of less than 50 percent of the area median income. A moderate-income

continue the practice of "redlining" – the systematic denial of various financial services based on an individual's location rather than on their qualifications and credit worthiness. Since most of the "redlined" neighborhoods were inner-city communities predominately occupied by the African American minority, it allowed banks to continue to discriminate primarily on the basis of race. It became clear that simply making inequitable practices in the banking industry illegal through these acts was not sufficient to reverse the legacy of discrimination that infiltrated housing and community investments. The CRA was enacted with the purpose of creating an incentive to encourage banks to reinvest in local communities. The CRA does not mandate sanctions, fines, or charter withdrawals; however, a bank's CRA performance is considered when evaluating bank applications such as charters, branch openings, and most importantly, mergers and acquisitions. This performance consideration serves as a powerful incentive for financial institutions to comply with the CRA, as failure to comply may hinder a bank's ability to achieve growth initiatives and strategic plan objectives.

Three federal regulatory banking agencies – the Federal Reserve System (Federal Reserve), the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC), collectively the supervisory agencies – are responsible for administering the CRA and evaluating bank compliance with the law. These supervisory agencies are members of the Federal Financial Institutions Examination Council (FFIEC), a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the federal examination of financial institutions. These supervisory agencies administer CRA using uniform, interagency rules and examination procedures outlined in the CRA methodology

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community means that the median family income is at least 50 percent and less than 80 percent of the area median income.

section of this paper. These supervisory agencies conduct periodic examinations of the financial institutions that they regulate. CRA does not apply to independent mortgage companies or credit unions. The Federal Reserve is the primary federal supervisor of state-chartered banks that have opted to join the Federal Reserve System. At the end of 2019, a total of 1,540 banks (excluding non-depository trust companies and private banks) were members of the Federal Reserve System.[2] The FDIC is the primary federal regulator of 3,347 state-chartered banks and savings associations that did not join the Federal Reserve System (non-member banks).[3] The OCC supervises approximately 1,143 national banks and federal savings associations.[4]

The U.S. banking industry has experienced significant organizational and technological changes, including the evolution of online and mobile banking, interstate banking, and branchless banks. Given the advancement of the banking industry since the CRA was enacted four decades ago, it is sensible to consider modernizing the regulation to align with current innovations in the financial services industry. In June 2017, the U.S. Department of the Treasury (Treasury) issued a report indicating that it is critical for Congress and the regulatory agencies to perform a holistic analysis of the federal regulatory environment. The Treasury noted the importance to better align the benefits arising from banks' CRA investments with the interest and need09 of the communities that they serve and to improve the current supervisory and regulatory framework for CRA. Specifically, the Treasury indicated that regulatory oversight must be harmonized, greater clarity in remediating deficiencies must be achieved, and the outdated CRA statute must be modernized to conform to the realities of the current financial system and needs

[2] 2019 Federal Reserve Board Annual Report. Figure as of December 31, 2019. https://www.federalreserve.gov/publications/2019
[3] 2019 FDIC Annual Report. Figure as of December 31, 2019. https://www.fdic.gov/financial-reports/2019.pdf
[4] 2019 OCC Annual Report. Figure as of September 30, 2019. https://occ.gov/2019-annual-report.pdf

of the communities. The Treasury performed a comprehensive assessment of the CRA and met with various stakeholders' – regulatory agencies, bankers, legislators, community groups, and consumer advocates – to solicit input on how the CRA statute could effectively encourage economic growth. Based on the analysis and stakeholder input, the Treasury issued recommendations to the supervisory agencies for broad changes to the administration of the CRA. In general, the recommendations focused on four key areas:

> **Assessment Areas**. Update the approach to delineating geographic assessment areas to include areas where the bank is physically located as well as LMI communities outside of the bank's physical location.

> **Examination Process**. Improve the evaluation process to increase timeliness of examinations and publication of performance ratings and to enable great accountability for banks' CRA activity planning. Incorporate a standardized examination schedule across the supervisory agencies.

> **Examination Clarity, Simplicity, and Flexibility**. Increase the clarity and flexibility of CRA evaluations to foster transparency and effectiveness in CRA rating determinations. Measure CRA activity against a well-defined and consistent unit of measurement.

> **Performance**. Incorporate additional performance incentives to encourage banks to meet the credit and deposit needs of their community. Improve the current

regulatory approach that correlates CRA compliance performance with approval of bank applications.

Modernizing the CRA has been a top priority of the OCC under the direction of Comptroller of the Currency Joseph Otting and in 2018, the OCC spearheaded the efforts to modernize the CRA by issuing an Advanced Notice of Proposed Rulemaking on reforming the CRA regulatory framework. The OCC, along with the FDIC and Federal Reserve, reviewed over 1,500 comments submitted by the public and held hearings with various stakeholders to discuss the reform. The OCC issued a proposal in December 2019, with support from the FDIC, to strengthen the CRA statute by making the framework more objective, transparent, consistent, and comprehensible. To achieve these goals, the two agencies proposed to make changes in the key areas by: (1) Clarifying and expanding what qualifies for CRA credit; (2) expanding where CRA activity counts; (3) providing an objective method to measure CRA activity; and (4) revising data collection, recordkeeping, and reporting. "These changes would encourage banks to serve their entire communities, including LMI neighborhoods, more effectively through a clearer set of CRA activities and would provide clarity for all stakeholders", as stated in the proposal.[5] Notably, the Federal Reserve refused to support the proposal. Federal Reserve Governor Lael Brainard stated during a speech "Any modernization of the Community Reinvestment Act must further the goal at the heart of the statute—encouraging banks to meet the credit needs of local low- and moderate-income communities". Brainard continued by

[5] Federal Register. Vol. 85, No. 6 - Proposed Rules. Docket ID OCC-2018-0008. *Joint Notice of Proposed Rulemaking.* https://www.federalregister.gov/documents/2019.CRA

stating, "If the past is any guide, major updates to the CRA regulations happen once every few decades. So it is much more important to get reform right than to do it quickly".[6]

The modernization proposal for the CRA raises a number of concerns from federal and state regulators, legislators, non-profit organizations, and community activist groups. Without support for the CRA modernization proposal from the Federal Reserve (and later the FDIC), banks would be subject to different federal CRA rules, which could result in legal issues.[7] More significantly, the proposed changes to the CRA threaten the primary goal at the heart of the statute. The proposed changes would reduce federal responsibility to monitor CRA banking equity and could potentially have a long-lasting and adverse effect on the LMI communities and their access to financial services.

This paper will outline the proposed changes for the modernization of the CRA, highlighting both supportive and opposing factors of the CRA proposal. Both the OCC and FDIC identified the main objectives of the proposed rule are to increase CRA activity in LMI communities, increase transparency, and enhance the assessment process. However, the impact of this proposed rule would weaken CRA-related lending, investing, and servicing to the LMI communities and erase decades of economic opportunities afforded to the LMI communities as a result of the enactment of this revolutionary civil rights law.

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[6] *Strengthening the Community Reinvestment Act by Staying True to Its Core Purpose*. Speech at the Urban Institute, Washington, DC. https://www.federalreserve.gov/newsevents/speech/brainard20200108a.htm

Part II: Research Methodology: Data Sources and Analysis

Research information for this paper was obtained through secondary data. The methods to gather research information included searches of online reports, periodicals, banking and demographic databases, and federal registers. The research included a review of current CRA regulations. Since its enactment, the CRA regulations were updated two times, once in 1995 and most recently in 2005. The supervisory agencies approved examination procedures to implement the revised CRA regulations. Each supervisory agency has its own set of examination procedures that reflect the intent of the regulation to establish performance-based CRA examinations. Research for this paper derived from the FDIC's Compliance Examination Manual, section XI, Community Reinvestment Act. The examination manuals from the other supervisory agencies were also reviewed to ensure conformity.

The 2018 Joint Advanced Notice of Proposed Rulemaking issued by the FDIC and the OCC, is the primary research document used for this paper.[8] This document provided the framework of all proposed CRA rulemaking changes. The supervisory agencies received numerous comments from stakeholders regarding the proposed changes and issued an updated Joint Advanced Notice of Proposed Rulemaking in January 2020. Stakeholders were able to provide comments about the proposed rule through March 2020. A number of journals, published reports, news articles, and expression of opinion letters were used to assess the proposed changes and both opposing and supporting viewpoints from stakeholders. The

[7] The FDIC issued a statement indicating that the agency is not prepared to finalize the CRA modernization efforts and withdrew its support for the proposal. https://www.fdic.gov/news/speeches/spmay2020.html

[8] On May 20, 2020 the OCC issued a final rule for CRA modernization. The research and methodology used in this paper derives from the Joint Notice of Proposed Rule Making issued by the OCC and FDIC in January 2020. The proposed ruling provides additional commentary from stakeholders that was utilized for this report.

National Community Reinvestment Coalition, American Banker Association, Urban Institute, Consumer Banker Association, and various community advocacy groups are examples of organizations that published articles or provided commentary in support or opposition of the proposed rule.

Various databases were used to gather banking and demographic information. Sources used to pull data included the FFIEC Interagency CRA Rating and the Census Bureau database. These databases were used to review CRA public disclosures of financial institutions, demographics, and housing information. Research methodologies included reviewing the trend of homeownership rates among race demographics and reviewing public disclosures of financial institutions that received a CRA rating of "Needs to Improve". Since the African American and Latino demographics comprise the majority of the low- to moderate-income communities, homeownership rates of these demographics were assessed. Metropolitan Statistical Area (MSA) data for the Philadelphia metropolitan area was assessed to support a working paper that outlines the effect of mortgage activity when the CRA eligible status of various census tracts located in the Philadelphia MSA was removed. These various databases, news articles, and working papers, coupled with the Joint Advanced Notice of Proposed Rulemaking, were utilized to provide a comprehensive assessment of the effect of the CRA proposed rule changes with an emphasis on the effects to the low- to moderate-income communities.

Research limitations included the inability to gather information through direct observation by participating in the CRA examination process of a financial institution. In addition, some data information and chart tables pulled from the Census Bureau website did not date back further than the 1980's for some variables.

Part III: Findings and Conclusions

Current CRA Methodology – Key evaluation factors

The supervisory agencies evaluate how well financial institutions meet the needs of their communities by evaluating the CRA activity in defined assessment areas using one of five evaluation methods. All banks subject to the CRA has a defined assessment area that typically encompasses the geographic area that can reasonably be served by the bank's main office, branches, and banking facilities. It also includes the surrounding areas in which the bank originated or purchased a substantial portion of loans. Assessment areas are either in a metropolitan statistical area (MSA) or metropolitan division (MD), which is a key factor in determining how to categorize the assessment area's constituent parts by income level.

The five evaluation methods are designed to respond to basic differences in institutions' structures and operations. Three of the evaluation methods utilize the primary basis for determination – a bank's asset size. Further, one method is based on a bank's business strategy and one method is an option that any bank can take advantage of, regardless of size or business strategy. The regulations provide (1) a streamlined assessment method for small institutions that emphasizes lending performance; (2) an assessment method for intermediate small institutions that uses the same lending test used in the small institution examination method, as well as a flexible community development test; (3) an assessment method for large institutions that focuses on lending, investment, and service performance; (4) an assessment method for wholesale and limited-purpose institutions that is based on community development activities; and (5) an assessment method based on the strategic plans of an institution.

Table 1: CRA Evaluation Methods by Bank Size

Evaluation method	Bank asset threshold	Evaluation components required
Small Bank	Less than $326 million	Streamlined lending test
Intermediate Small Bank	$326 million but less than $1.305 billion	Lending test Community development test
Large Bank	Greater than $1.305 billion	Lending test Investment test Service Test

A small institution is defined as a bank that, as of December 31 of either of the prior two calendar years, had assets of less than $326 million. The limited financial resources and competitive factors of small banks warrant a streamlined assessment method. The small bank lending test incorporates a bank's seasonally adjusted loan-to-deposit ratio, percentage of loans within the assessment area, record of lending to LMI individuals, and the record of complaints about its performance in helping the community.

An intermediate small institution is defined as a financial institution with assets of at least $326 million as of December 31 of both of the prior two calendar years and less than $1.305 billion as of December 31 of either of the prior two calendar years. Intermediate small institutions are evaluated using two component tests: the small institution lending test and the flexible community development test for intermediate small institutions. The intermediate small institution community development test evaluates the number and amount of community development loans; the number and amount of qualified investments; the extent to which the institution provides community development services; and the institution's responsiveness to the opportunities of community development lending, qualified investment, and community development services.

A large institution has total assets of at least $1.305 billion for December 31 of both of the prior two years. Large institutions are evaluated using three performance tests – the lending, investment, and service tests.

The lending test evaluates a large institution's retail lending, as well as its community development lending, using various factors including the number and dollar amount of the institution's home mortgage, small business, small farm, and consumer loans in the institution's assessment areas; the geographic distribution of the institution's lending products, and the level of complexity and innovativeness of community development loans.

The investment test evaluates an institution's record of making qualified investments by assessing the dollar amount of qualified investments, innovativeness or complexity of qualified investments, and the responsiveness of qualified investments to credit and community development needs.

The service test evaluates an institution's use of retail and community development services to meet the needs of the assessment area by measuring the current distribution of branches in LMI communities, and the availability and effectiveness of a bank to deliver services to LMI areas and individuals.

An institution must receive approval from its primary regulator to be designated as a wholesale or limited-purpose institution under which it will be evaluated using the community development test. CRA regulations permit any institution to develop, and submit for approval by its primary regulator, a strategic plan for addressing its responsibilities with respect to CRA.

<u>CRA Rating System</u>

A bank's CRA rating is based on the evaluation of the various performance tests.[9] The bank's overall performance must be consistent with safe and sound banking practices and adjustments on the basis of evidence of discriminatory or other illegal credit may be applied. Having a "Satisfactory" or better CRA rating is considered when banks submit applications for charters, branch relocations, and mergers and acquisitions. Since CRA ratings are made publicly available, banks are motivated to strive for high CRA ratings to protect its reputational risk as some community businesses, federal government agencies, and state and local governments will only place deposits with banks that have earned high CRA ratings.

The CRA ratings assigned based on the evaluation of a bank's performance are:

"Outstanding" An institution in this group has an outstanding record of helping to meet the credit needs of its assessment area, including low- and moderate-income neighborhoods, in a manner consistent with its resources and capabilities.

[9] FDIC Consumer Compliance Examination Manual- Community Reinvestment Act Section XI. https://www.fdic.gov/resources/examinations/compliance-manual.pdf

"Satisfactory" An institution in this group has a satisfactory record of helping to meet the credit needs of its assessment area, including low- and moderate-income neighborhoods, in a manner consistent with its resources and capabilities.

"Needs to Improve" An institution in this group needs to improve its overall record of helping to meet the credit needs of its assessment area, including low- and moderate-income neighborhoods, in a manner consistent with its resources and capabilities.

"Substantial Noncompliance" An institution in this group has a substantially deficient record of helping to meet the credit needs of its assessment area, including low- and moderate-income neighborhoods, in a manner consistent with its resources and capabilities.

Proposed CRA Modernization Changes

In a joint press release announcing the proposed rule, the OCC and FDIC stated that the proposal is intended to address the dramatic changes that have occurred in the banking industry since the enactment of the CRA regulations.[10] The two agencies proposed to make changes in the key areas by: (1) Clarifying and expanding what qualifies for CRA credit; (2) expanding where CRA activity counts; (3) providing an objective method to measure CRA activity; and (4) revising data collection, recordkeeping, and reporting.[11]

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[10] OCC News Release 2019-147/December 12, 2019. *FDIC and OCC Propose to Modernize Community Reinvestment Act Regulations*. https://www.occ.gov/news-issuances/news-releases/2019

[11] Primary source documents for the proposed rule changes are the Federal Register/Vol. 85, No. 6/ Proposed CRA Rules and the Wisconsin Bankers Association summary document *Changes to Community Reinvestment Act Proposed by Regulators*. https://www.wisbank.com/articles/2020/changes-to-CRA

1. Clarifying and expanding what qualifies for CRA credit

The proposed rule seeks to clarify and expand the set of activities eligible for CRA credit, require the publication of a non-exhaustive list of eligible activities, and create a process for getting guidance on an activity's eligibility prior to a bank fully engaging and/or committing to an investment. The proposal would clearly define qualifying activities criteria that identify the types of activities that meet the credit needs of banks' communities, particularly those individuals and areas deemed as low-to-moderate income. The proposed rule would encompass the many activities that qualify for CRA under the current rule such as retail loans provided to LMI individuals, small businesses and farms and community development activity such as affordable housing and essential community support facilities. The proposed rule would expand the list of qualifying activities to include new activities such as retail loans to Indian country and consumer lending for the evaluation of community development. Historically, banks have not received CRA credit for lending activity in tribal areas primarily because bank branches are not located on or near Indian reservations; however, the new proposed rule would incentivize banks to provide services to tribal and rural areas since banks will receive CRA credit even if the reservations are not in near proximity to a branch. This will make capital and credit opportunities more accessible for tribal governments and communities. On the contrary, the proposed rule will expand qualifying activities to include consumer lending for the evaluation of community development. This could potentially discourage banks from issuing loans such as mortgages and business loans to receive CRA credits and instead issue smaller credits such as personal or automobile loans.[12] Mortgages and small business loans better support growth and rehabilitation within a community and by including consumer loans, a bank could reduce the volume of loans that produce economic development (mortgages and business loans) and opt for originating loans such as small personal and automobile loans to satisfy CRA obligations.

The new proposal would calculate CRA investments on an ongoing basis of the average outstanding amount of any qualifying loan or CD investment on the bank's balance sheet. Currently, the CRA evaluation period is scored on a three-year basis and investments older than three years do not count towards CRA credit. The proposed rule could reduce the current short-term focus of CRA activities and provide banks more incentive to engage in community development investments and loans with longer maturities. When a CRA exam is expect to commence, banks often purchase loans or investments that qualify for CRA credit and then sell the loans shortly after the examination period is complete. Expanding the evaluation period greater than three years could eliminate the apparent inflation then sell-off of qualifying CRA activity. Contrary, by allowing banks to receive CRA credit longer than three years for qualifying activity could potentially encourage banks to focus only on long-term CRA-qualifying loans to meet rule thresholds and then cease lending to the community in subsequent years.

Under the proposed rule, the agencies would maintain a publicly available non-exhaustive, illustrative list of examples of qualifying activities that meet the criteria in the rule, as well as examples of activities that the agencies have determined do and do not qualify for CRA credits. The proposal would also establish a process for a bank to seek agency confirmation that an activity is a qualifying activity prior to full engagement or commitment of the activity. These changes could address concerns about uncertainty and transparency that have been identified by stakeholders.

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[12] The proposed rule excludes credit card loans, which are classified as a consumer loan, as qualifying activity.

2. Expanding where CRA activity counts

The banking industry has changed significantly since CRA was originally enacted, as technology and the expansion of interstate banking has transformed how banks deliver their products and services. As mobile and internet banking have evolved, banking communities have developed beyond those that are solely identifiable by the delineated areas surrounding banks' physical locations. The proposed rule would expand CRA assessment areas by offering banks greater flexibility to designate statewide, non-metropolitan assessment areas that are outside of communities surrounding a physical location or where the majority of business activity is conducted.

The proposed rule would create two categories of assessment areas: facility-based and deposit-based assessment areas. The current requirement that areas surrounding a bank's main office, branches, and facilities are delineated as assessment areas for the purpose of measuring CRA performance would be preserved. These areas would be identified as facility-based assessment areas and the banks will have the option to choose the geographic level at which to delineate their facility-based assessment areas. The agencies believe that banks are in the best position to determine the bank's assessment areas. The proposed rule would require banks that receive 50% or more of its retail domestic deposits from geographic areas outside of its facility-based assessment areas to delineate separate, non-overlapping deposit-based assessment areas where they receive five percent or more of their retail domestic deposits. These deposit-based assessment areas would capture banks' evolving business of internet and mobile deposits and encourage banks to serve communities including deposit-taking areas outside of current assessment areas.

In addition, the proposed rule would allow banks to receive credit for qualifying activities conducted outside of its assessment areas in communities where banks have limited physical or deposit presence. The proposal would permit a bank to change its assessment area once during each evaluation period while retaining the requirements that a bank's assessment areas must not illegally discriminate or exclude LMI geographies. Although these component of the proposed rule would increase retail lending to LMI individuals and businesses that are located outside of assessment areas, it could potentially reduce the amount of lending to LMI communities as banks would be more incentivized to participate in CRA-qualifying projects or LMI individuals located in more "desirable" neighborhoods rather than provide CRA-qualifying activities in LMI communities that need more revitalization and development opportunities.

3. Providing an objective method to measure CRA activity

The current CRA regulations specify different methods to evaluate a bank's CRA performance based on the bank's asset size (small, intermediate small, and large banks) and business strategy. The proposed rule would establish new general performance standards used to evaluate banks with an asset size greater than $500 million. Small banks (classified as banks with an asset size of $500 million or less) may choose to opt into the new general performance standards or continue to be evaluated based on the small bank performance standards under the current regulations.

The proposed rule would make the evaluation of CRA performance more objective and standardized by establishing new performance standards based on specific benchmarks and thresholds. The proposed rule would eliminate the three separate fully-rated lending, investment, and service tests outlined in the current regulations. The new general performance standards would apply at both the bank and assessment area levels and would assess two fundamental components: (1) a CRA evaluation measure (EM); and (2) a retail lending distribution test. Additional performance measures would require banks to meet minimum CD lending and investment requirements in each assessment area.

Under the proposed rule, the EM will provide a uniform method of evaluating the impact of a bank's qualifying activities and specify benchmarks required to achieve specific ratings categories. The EM is comprised of two components: (1) a measurement of a bank's qualifying activities; and (2) a measurement of a bank's branch distribution. The first component is derived by taking the sum of its qualifying activities (dollar value) as a proportion of quarterly retail domestic deposits. The second component of the EM is calculating a bank's distribution of branches located in LMI census tracts, tribal and native lands, underserved areas, and distressed areas within an assessment area. The number of branches located in the assessment areas will be compared to the bank's total number of branches and multiplied by .01 to produce an EM score. Banks will receive the following rating if the average EM meets or exceeds: 11% for "Outstanding", (2) 6% for "Satisfactory", (3) 3% for "Needs to Improve", and (4) <3% for "Substantial Noncompliance".

There is no way to assess whether the proposed EM thresholds are appropriate or consistent across bank sizes or business models. The agencies did not release the research and underlying data used to establish the EM thresholds and admitted in the notice of the proposed rule that the data was incomplete and required the use of assumptions. It presents a concerning possibility that the proposed EM thresholds have not been proven accurate or effective for measuring CRA. In addition, there could potentially be great pressure within banks to calculate the ratio of CRA-qualifying activities in the normal course of business, identify the dollar volume yet remaining to achieve the 11% ratio to achieve an "Outstanding" rating, and then seek out the fastest and simplest options to meet the threshold. This could potentially come at the expense of smaller dollar retail loans, community development loans, and loans that require more complex underwriting, all of which are the fundamental basis for redevelopment in LMI communities.

Table 2: Summary Chart of specific benchmarks for each general performance standards

CRA evaluation	Retail lending distribution tests	CD minimums	Presumptive rating category
The average of a bank's annual assessment area CRA evaluation measures meets or exceeds 11 percent (selected from a range of 10 to 15 percent).	A bank meets the established thresholds for all 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 percent.	Outstanding.
The average of a bank's annual assessment area CRA evaluation measures meets or exceeds 6 percent (selected from a range of 5 to 10 percent).	A bank meets the established thresholds for all 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 percent.	Satisfactory.
The average of a bank's annual assessment area CRA evaluation measures meets or exceeds 3 percent (selected from a range of 2 to 5 percent).			Needs Improvement.
The average of a bank's annual assessment area CRA evaluation measures is less than 3 percent (selected from a range of 0 to 5 percent).			Substantial Non-compliance.

Source: Federal Register/Vol. 85, No. 6/ Proposed CRA Rules

The retail lending distribution tests would assess if a bank's retail loan originations are serving the needs of LMI individuals and communities. The tests evaluate the volume of bank originations in each assessment area, based on its major retail lending product lines, using both a geographic distribution test and a borrower distribution test.[13] The geographic distribution test compares the bank's rate of small business loan originations in LMI neighborhoods to its peer and the demographics of the assessment areas. The borrower distribution tests compare a bank's rate of originations of home mortgages and other retail loans to LMI individuals to its peers and demographics of the assessment areas. Both distribution tests will only be conducted on assessment areas having at least 20 loans in the major retail lending product line. The proposed rule uses a pass-fail approach and a bank's performance on the geographic and borrower lending distribution tests must meet or exceed the established thresholds for performance in order to pass each test.[14] Since the retail test would be only pass or fail, the evaluation measure would have much more weight when determining overall scores.

The final component of the new general performance standards is the community development minimums. The proposed rule would establish minimums for a bank's quantified value of CD lending and investments as compared to retail domestic deposits at both the assessment area and bank level and it would be evaluated using a pass-fail approach. To achieve a "Satisfactory" or an "Outstanding" rating, the sum of the quantified value of community development loans and community development investments, divided by the average of the bank's retail domestic deposits must meet or exceed 2%.

While it is progress to establish threshold benchmarks for the demographic and peer comparators, the proposed rule does not provide supporting data to explain the rationale for the

[13] A major retail lending product line is defined as any retail lending product line that composes at least 15 percent of the bank's overall dollar volume of retail loan originations during the evaluation period. If more than two retail lending product lines comprise more than 15 percent of a bank's retail lending, the two largest retail lending product lines will be considered major retail lending product lines.
[14] The thresholds are set at 55% and 65% for the demographic comparator and peer comparator for both the geographic distribution test and the borrower distribution test. See Federal Register for the breakdown of the numerators and denominators.

55% and 65% benchmarks. The proposed rule does not outline any assumptions used or data analysis conducted to determine if the threshold benchmarks are adequate to satisfy CRA lending in different communities or if a uniform threshold is appropriate as development and lending opportunities differ in various communities. For example, the 55% demographic benchmark might be too low in lower-cost areas where it is easier to lend to LMI borrowers or too high in higher-cost areas where it is harder to lend to LMI borrowers. In addition, the proposed rule does not explain how 2% of deposits was determined to be a significant level of community development activity.

The one ratio EM would be the dollar amount of qualified CRA activities divided by the bank's quarterly average for retail deposits for each assessment and at the bank level. Furthermore, the retail lending and CD minimums components would carry less weight resulting in this single ratio measure being the primary determinative factor for CRA purposes. Since this ratio focuses on the "dollar value" of CRA-qualifying activities rather than on the complexity and impact that it will contribute to serving community needs, banks will have an incentive to meet CRA obligations by making large investments in projects that might have only limited impacts on the needs of LMI individuals and communities. For example, facilitating one large loan to repair the parking lot/garage of a sports stadium located in an LMI community would yield more CRA credits than facilitating various small mortgages and business loans to LMI individuals and businesses within the community. These smaller retail loans help support the development, revitalization, and stabilization of distressed or LMI communities at a much greater level than a large development loan for a sports stadium or similar large credit.

4. Revising data collection, recordkeeping, and reporting

Under the proposed rule, there would be separate data collection and reporting requirements for banks subject to the new general performance standards and for banks subject to the small bank performance standards. Banks evaluated under the new general performance standards would be required to collect and maintain extensive information such as retail lending distribution tests results, CRA evaluation measures calculations, and presumptive ratings determinations. Banks would also be required to collect and maintain records of all qualifying and non-qualifying retail loans, assessment area lists, qualifying activities data and retail domestic deposit data at the census-tract level and report at the county level. Also, banks would be required to collect and maintain information on home mortgage and consumer loans originations that do not qualify for CRA credit. For each of those loans, a bank would be required to collect and maintain a unique identification number, the loan type, the date of origination, the loan amount at origination, the loan location, and the income of the borrower. Banks evaluated under the small bank performance standards would generally be exempt from the data collection, recordkeeping, and reporting requirements. These banks would only be required to collect and maintain information on retail domestic deposits, based on the physical address of the depositor. Exempting small banks from collecting and maintain all of the information needed to satisfy the data collection, recordkeeping, and reporting requirements would reduce burden in that manner; however, the requirement to report and maintain deposit information based on the physical location of the depositor may actually demand more burden for small banks. Currently, all banks are required to submit the annual Summary of Deposits (SOD) survey which records deposits by allocating them to a branch location, rather than the location of the depositor. This survey is used to assess compliance with other rules and regulations including for the purpose of CRA. Small banks would have to allocate resources for updating software systems and contacting all customers via phone or mail to confirm or request updated physical location information, all of which may potentially cause additional burdens for small banks. Also, depositor information based on physical location may not be accurately reflected in recordkeeping in order to provide meaningful analysis for CRA purposes. For example, a millennial that opened an account while residing at their parents' house may not feel obligated to contact a bank to update their new address given the mobile and paperless banking environment.

The referenced changes are the fundamental changes within the four key areas noted by the Treasury and the two regulatory agencies. The following are additional changes outlined in the proposed rule that could potentially have a significant effect on the CRA regulations:

- Small business loans and small farm loans – The eligible size of a loan that qualifies as a small business loan or small farm loan in an LMI community would increase from $1 million to $2 million. Although increasing the eligible size will allow more credits to be considered for CRA purposes, increasing this limit could potentially lure banks to focus only on larger credits instead of originating smaller home mortgages and business loans in LMIs.
- Home Mortgage Loans – Home mortgage loans made to high-and middle-income individuals living in LMI areas would no longer receive CRA consideration. This will have a positive effect on lending to LMI individuals.
- Inconsistent CRA framework among banking agencies – At inception, the Federal Reserve did not support the proposed changes for CRA modernization. The FDIC

later withdrew its approval of the proposed ruling. As a result, there will be separate regulatory requirements for OCC-supervised banks.

<u>The Impact of Losing CRA-Eligible Status</u>

The proposed rule has the potential to adversely affect LMI communities by reducing the incentives for banks to conduct business in LMI communities in order to obtain CRA credits. Since the rule has not been implemented yet, a historical “lookback” or tangible data analysis review cannot be conducted. The proposed rule would need to be effective for several years to measure the true impact of the rule since the agencies did not employ a testing phase to collect data prior to the proposal. Since employing the proposed rule will reduce the incentive to conduct business in LMI communities as supported throughout this document, the best way to fully measure the impact to communities is by reviewing the data trends of communities that previously lost their CRA-eligible status. In 2013, the Office of Management and Budget (OMB) published a new set of MSA definitions as part of its comprehensive review of statistical area standards. Consequently, median family income calculations changed for various census tracts resulting in the change of CRA-eligible status for various zip codes. The Federal Reserve Bank of Philadelphia conducted data analysis of banks within the Philadelphia MSA that either lost or gained CRA-eligibility status as a result of the OMB revisions, and analyzed the impact that this status change had on communities.

The loss of CRA eligibility status in Philadelphia MSA census tracts led to a decrease of 10% to 20% in the volume of purchase mortgage originations by CRA-regulated lenders.[15]

Table 3: Changes in Purchase Mortgage Lending Pre- and Post-2014 in the Philadelphia area

	Applications		Originations		Origination Volume ($)		Denial Rate (%)		FHA Share (%)	
	Newly Ineligible	Control	Newly Ineligible	Control	Newly Ineligible	Control	Newly Ineligible	Control	Newly Ineligible	Control
Depository Institutions with Local Branches										
2012–2013	2,422	2,818	1,577	1,836	218,895	272,320	23.6%	23.4%	44.8%	41.1%
2014–2015	2,365	3,188	1,675	2,234	257,005	358,337	19.2%	19.4%	34.1%	30.1%
% Change	−2.4%	13.1%	6.2%	21.7%	17.4%	31.6%	−4.4%	−4.0%	−10.7%	−11.0%
Difference in Differences	−15.5%		−15.5%		−14.2%		−0.4%		0.3%	
Nondepository Institutions										
2012–2013	3,504	3,914	2,370	2,613	356,866	406,140	17.5%	17.8%	50.4%	47.5%
2014–2015	4,578	5,306	3,212	3,630	506,240	604,808	13.4%	14.7%	45.4%	41.0%
% Change	30.7%	35.6%	35.5%	38.9%	41.9%	48.9%	−4.1%	−3.0%	−5.1%	−6.5%
Difference in Differences	−4.9%		−3.4%		−7.1%		−1.1%		1.4%	
All Lending Institutions										
2012–2013	7,548	8,497	5,087	5,656	736,112	856,983	19.6%	20.0%	50.7%	46.9%
2014–2015	8,551	10,559	6,046	7,331	950,675	1,205,136	15.4%	16.2%	41.5%	36.9%
% Change	13.3%	24.3%	18.9%	29.6%	29.1%	40.6%	−4.3%	−3.8%	−9.2%	−10.0%
Difference in Differences	−11.0%		−10.8%		−11.5%		−0.4%		0.8%	

Notes: The control group refers to the tracts within 0.5 mile of any neighborhood in the treatment group and with slightly lower or slightly higher income (about 50%–90% AFMI). Changes for the volume of applications and originations are relative changes; changes for the denial rate and FHA share are absolute changes.
Source: Authors' calculation based on HMDA data and FDIC SOD data.

Source: Lei Ding and Leonard Nakamura (footnote 15)

Furthermore, data analysis from the report (Ding and Nakamura, 2020) delineates lending activity into purchase applications and originations. In 2014, the growth rate of purchase applications accepted by CRA-regulated lenders was negative 2.4% for newly ineligible census tracts compared to 13.1% for the control group (census tracts within 0.5 miles that retained CRA-eligible status). Within the same period, the growth rate of mortgage originations for newly ineligible census tracts was 6.2% compared to 21.7% in the control group. The change in lending patterns of the newly ineligible neighborhoods are consistent with the concept that CRA has made mortgage credit more accessible for households in LMI communities. Furthermore, it

[15] Lei Ding and Leonard Nakamura. "Don't Know What You Got Till It's Gone" – The Community Reinvestment Act is a Financial Landscape. February 2020. https://www.philadelphiafed.org/working-papers/2020/wp20-08.pdf

supports the theory that bank will reduce lending practices in LMI communities if they do not have the incentive to gain CRA credits.

The CRA effects are more pronounced among minority borrowers and borrowers who used to qualify for CRA credit but became newly ineligible. Without the incentive of CRA, depository institutions are less likely to keep up or expand their supply of mortgage credits in LMI communities. In the Philadelphia MSA study, regression analysis revealed that purchase applications for minorities had a coefficient factor of negative 1.125 compared to 0.371in the control group.[16] This supports the principle that lenders tend to reduce the supply of mortgage credits to minority borrowers and borrowers who no longer qualify for CRA credit.

The National Community Reinvestment Coalition conducted data analysis of CRA and Home Mortgage Disclosure Act (HMDA) during the years 2012 through 2016 to calculate the sum of loan amounts made for every census tract in the United States. This analysis corresponded with the Philadelphia MSA study and signified a decrease of 10% to 20% in the volume of loans to LMI communities would occur if the proposed rule became effective. Nationally, this would result in a loss between $52 billion and $105 billion in loans in the LMI census tracts over a five year period.

[16] Coefficients can be interpreted as the change in mortgage lending activity in tracts with changed CRA eligibility status, relative to that of the control group.

Diagram 1: Estimated Loss of Lending

Source: National Community Reinvestment Coalition

The Relationship between the CRA Rating under the Proposal and Existing Rating

In order to determine if the proposed rule and new methodology will still encourage banks to conduct business in LMI communities, various stakeholders and community groups reexamined previously-rated CRA exams and applied the new methodology to these exams. After reviewing a sample of previously-rated exams, stakeholders concluded that the regulators' goal of replicating the existing ratings system was not met and banks received higher ratings under the new methodology. For the 22 largest banks, 72.7% of these banks would receive an "Outstanding" rating, and 13.6% would receive a "Satisfactory" rating. Under the existing rating system, 54.5% and 40.9% of these banks had "Outstanding" and "Satisfactory" ratings, respectively. Of the 396 banks with assets between $1.25 and $10 billion, 84.1% would receive an "Outstanding" rating in the proposed rating and 0.3% would be "Satisfactory", compared to 7.3% "Outstanding" and 85.4% "Satisfactory" under the existing system. Even more troubling, 23 of the 29 institutions that received a "Needs to Improve" rating would move to an "Outstanding" rating with only six remaining as "Needs to Improve".[17] This suggests that banks would be able to achieve a rating of "Satisfactory" or above without improving CRA performance through the extension of credit to the LMI communities. Further, the proposal could encourage banks to cut back on CRA-eligible activities.

Table 4: Components of the Rating under the Proposal

		Components				Proposed Rating		Existing Rating	
Bank size (assets)	N	Bank-wide CRA evaluation metric: Outstanding	Bank-wide CRA evaluation metric: Satisfactory	CD pass	Retail lending pass	Outstanding	Satisfactory	Outstanding	Satisfactory
>$100 billion	22	72.7%	18.2%	90.9%	100.0%	72.7%	13.6%	54.5%	40.9%
$10 billion to $100 billion	82	93.9%	4.9%	92.7%	95.1%	85.4%	3.7%	15.9%	80.5%
$1.25 billion to $10 billion	396	96.2%	1.5%	93.7%	90.4%	84.1%	0.3%	7.3%	85.4%
$500 million to $1.25 billion	107	96.3%	1.9%	90.7%	93.5%	85.0%	0.0%	4.7%	81.3%
≤$500 million	21	90.5%	4.8%	71.4%	100.0%	71.4%	0.0%	4.8%	81.0%
All	628	94.9%	2.7%	92.2%	92.2%	83.6%	1.1%	9.6%	82.3%

Source: Urban Institute

Conclusion

For the past four decades, CRA has been a critical tool in providing loan and investment activity to LMI individuals and poorly-served communities. Given the advancement of the banking industry since the CRA, it is sensible to consider modernizing the regulation to align with current innovations in the financial services industry. However, any changes to this critical

[17] Urban Institute: Response letter to OCC Docket ID OCC-2018-0008; (Advance Notice of Proposed Rulemaking) https://www.urban.org/sites/publication/community-reinvestment-act-april-8-2020-comment-letter.pdf

tool should at a minimum seek to maintain the statutory intent to support investing and servicing to LMI communities across the country. The proposed rule has significant weaknesses and unknowns that will adversely affect the individuals and communities that it was intended to protect. The most significant weaknesses include a lack of agreement, complexity, and transparency.

Uniform implementation and oversight among the regulatory agencies is essential for any modernization efforts of a significant statute such as CRA. The Federal Reserve did not support the proposed rule at inception and the FDIC later withdrew support which indicates that there are substantial deficiencies within the proposed rule. It is crucial for the three agencies to collectively develop a proposal as a lack of alignment undermines the goal of the FFIEC and creates confusion for all stakeholders.

The proposed rule applies a one-ratio measure based primarily on the dollar value of CRA-eligible activities as a percentage of deposits. This oversimplified, quantitative approach (which serves as the major determinant of a CRA rating) does not consider factors such as complexity and innovation and will enable banks to shift away from smaller and more continuous financial transactions that address the local community needs and instead focus on higher dollar activities that do not fully encourage revitalization of LMI communities.

Data analysis is central to any major regulatory overhaul. Without the necessary data, regulatory agencies and stakeholders cannot fully determine how the proposed rule will affect communities and promote fair access to sustainable credit. The regulatory agencies proposed many changes to the CRA rule that relies on data that has not yet been collected. The methodology behind the proposed rule includes a great number of assumptions and the current information release is inadequate and lacks transparency. Numerical CRA rating thresholds were determined without publishing the full data and analysis that justified the development of these thresholds. The agencies proceeded despite these data gaps, releasing minimal underlying data which hinders transparency.

It is imperative to ensure that CRA continues to build upon its unparalleled legacy of expanding access to financial products and services to the LMI communities. Implementation of the propose rule has the potential to weaken CRA-related lending, investing, and servicing to the LMI communities and erase decades of economic opportunities afforded to the LMI communities as a result of the enactment of this statute. Without CRA, many LMI communities will lack access to capital and revitalization efforts will not occur. Evidence indicated that when census tracts lose CRA-eligible status, mortgage applications and originations declined significantly compared to areas that maintained CRA-eligible status. Banks are not incentivized to conduct business in LMI communities and the population within these communities often have to rely on nonbank institutions. The estimated multi-billion dollar lending loss due to the weakening of CRA would be detrimental to the efforts of closing the wealth gap and supporting stabilization in LMI communities.

Part IV: Recommendations

Although the new proposed ruling is a useful starting point, it is deficient and needs substantial revisions in order to capture the mission of the statute – encouraging banks to meet the credit needs of local LMI communities. Based on the content throughout this paper, the new proposed rule should be withdrawn and the recommendations highlighted below should be considered before moving forward with the modernization of the CRA.

First, the three regulatory agencies must work together to develop a single CRA modernization initiative that addresses the weaknesses in the current rule. The need for consensus among the federal regulatory agencies is fundamental for any change in regulatory banking statutes, especially for a statute of this magnitude. The Federal Reserve did not support the proposed rule at inception and indicated that it is more important to get reform right rather than quickly. Further, the Federal Reserve committed to release a separate proposal and the FDIC later withdrew support for the original proposal resulting in the possibility of having three separate regulatory statutes for CRA. Banks in the same community could be subject to different CRA frameworks and examination rules, causing confusion among stakeholders.

Second, the regulatory agencies must collect, analyze, and release the critical underlying data prior to pursuing modifications to a significant statute such as CRA. As outlined within this report, the proposed changes rely on deposit data that has not yet been collected. At the initial stage, the agencies should introduce a trial period in which the appropriate data is collected. A notification should be sent to all applicable banks to begin collecting deposit information based on the physical location of the depositors to determine how assessment areas are delineated. Without this information, it is impractical to determine if the proposed assessment area concentration thresholds are appropriate or if market share is the more suitable metric. Further, the regulatory agencies should perform thorough analysis to determine if the numerical thresholds for the EM and CD minimums are appropriate. The proposed rule contains many assumptions and insufficient data and analysis to support these assumptions. Specifically, the agencies assigned percentage thresholds for the EM which is the primary determinant of a CRA rating. The agencies did not provide any supporting analysis to substantiate if the thresholds properly correspond with each rating. The agencies must release all data and analysis in order for stakeholders and the public to fully understand how the propose rule will affect communities and promote fair access to sustainable credit. This will improve transparency and trust within the bank regulatory industry.

Third, the agencies must review a sample of previously-rated institutions and apply the new proposed rules to determine if the application of the new rules yield the same rating or significantly changed the overall CRA ratings of institutions. As supported throughout this paper, applying the new rule methodology to previously rated CRA exams suggests that the proposed rule would make it easier for banks to receive a higher rating without improving performance. The new rule could essentially encourage banks to cut back on CRA activities. After a through comparison review, the agencies must modify the proposed thresholds commensurate with the existing system and publish the underlying comparison analysis.

Last but most important, the regulatory agencies must reevaluate the proposed rule and methodological factors to ensure that the proposed changes continue to serve the original purpose of the law which is to help LMI communities gain access to financial services, loans, and community development investments that would otherwise be unavailable. CRA was enacted largely as a response to redlining and addressing the unmet credit needs of LMI communities and individuals must remain central to any modernized regulations and should be the standard against which any changes are measured. When reevaluating the new proposed rule, the agencies should ask, "Will the new rule further help or hurt the communities in which it was meant to serve?" The current proposed rule appears to benefit the banks more than individuals in the LMI community. With the new methodology primarily centered on a single-ratio measure and the small loan threshold increasing from $1 million to $2 million, banks will be incentivized to focus on large scale and high-dollar credits that may not abide by the purpose of the CRA. This will promote banks to finance large projects like a stadium verses originating smaller mortgages and business loans in the community. The current three-part exam structure – lending, services, and investments – must remain in place as it maintains the innovation and complexity components and reduces the focus on primarily dollar-volume. This encourages banks to include a number of critical affordable housing and community development activities, such as grants to non-profit organizations and housing credit investments.

CRA is a critical tool to direct lending and investment to LMI individuals and communities that would otherwise be poorly served by the banking system. For the past four decades, this statute has served to combat the legacy of redlining and racial wealth disparities. While the need to modernize the CRA is warranted given the advancement in technology and innovation within the banking industry, the proposed rule would undercut the efforts to assist individuals in LMI communities, potentially excluding them from the financial system. The regulatory agencies must come together to issue an interagency proposal that builds on the strengths of the existing CRA framework and truly addresses the need for banks to meet the credit and deposit needs of LMI communities and increase transparency.

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