Community Reinvestment Act Update

Update on the New CRA Rules and Litigation Challenging those Rules

April 22, 2024

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Agenda

- Overview of the new CRA rules finalized in October 2023
- Key differences from proposed rules
- Update on litigation challenging the rules
- Considerations for preparing for the new rules amidst uncertainty

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A Brief History of the CRA

- Congress enacted the CRA in 1977, and the banking agencies adopted regulations soon thereafter.
- The statute directs the agencies to evaluate banks' record of meeting the **"credit needs"** of their "**entire community**, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of such institution."

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A Brief History of the CRA, cont.

- The current CRA regulations set forth tests designed primarily to evaluate how well banks meet the credit needs of the communities in which they maintain brick and mortar locations.
- The CRA regulations had not been materially updated since 1995 and did not meaningfully account for the many changes in bank operations since that time.
- Historically, the CRA regulations also arguably resulted in evaluations that were subjective and lacked clarity and consistency.

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Summary of Recent Rulemaking

- On July 20, 2021, the OCC, Federal Reserve, and FDIC announced they would work collectively to develop a new, consistent CRA regulatory framework.
- On May 5, 2022, the agencies jointly issued a Notice of Proposed Rulemaking (NPRM) intended to modernize the agencies' CRA regulations.
- On October 24, 2023, agencies issued a joint final rule (Final Rule) that makes extensive amendments to the CRA regulations.

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Key Changes from Current CRA Regulations

The Final Rule adopted the most significant aspects of the NPRM, including:

- Stringent data-driven performance tests, with separate analyses of retail and community development activities;
- Expanding the geographic areas for retail lending evaluations and where community development activities may be counted;
- More in depth definitions of qualifying community development activities, including providing a publicly available, illustrative list of eligible activities; and
- Increasing asset size thresholds for applicable performance tests.

Key Changes from Proposed Rule

- The Final Rule reduces the number of product lines subject to analysis in the new Retail Lending Test.
- The Final Rule increases thresholds for the evaluation of banks in new Retail Lending Assessment Areas.
- The Final Rule also makes certain adjustments to the metrics and benchmarks in the NPRM that will purportedly make achieving a satisfactory or outstanding rating more achievable than under the NPRM.
- The Final Rule does not adopt the NPRM's controversial proposal to permit downgrades of a bank's CRA rating based on virtually any illegal practice, even those unrelated to credit and the core purposes of the CRA.

Asset-Size Thresholds

Current Asset-Size Thresholds

- Under current CRA rules, banks are classified into three categories based on asset size:
    - **"Small banks":** as of December 31 of either of the prior two calendar years, had assets of <u>less than $1.564 billion</u>.
    - **"Intermediate small banks":** <u>at least $391 million</u> as of December 31 of both of the prior two calendar years and <u>less than $1.564 billion</u> as of December 31 of either of the prior two calendar years.
    - **"Large banks":** assets of <u>at least $1.564 billion</u> as of December 31 of both of the prior two calendar years.
- Regulators' CRA evaluations depend on asset size. Large banks are subject to the most detailed and comprehensive requirements.

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New Asset-Size Thresholds

- **Small banks**
  - Assets of less than $600 million in either of the prior two calendar years.
- **Intermediate banks**
  - A substitute for the current "intermediate small" category.
  - Assets of at least $600 million in the prior two calendar years and less than $2 billion in either of the prior two calendar years.
- **Large Banks**
  - Assets of at least $2 billion in the prior two calendar years.
  - Banks with assets of at least $10 billion would be subject to additional requirements.

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CRA Assessment Areas

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Current Definitions of Assessment Areas

- Assessment areas are a central concept of the CRA regulation—these are the areas which regulators assess banks' CRA performance in examinations.
- Currently, a bank's CRA assessment area is primarily determined by where the bank has brick and mortar operations—a bank's main office, branches, and deposit-taking ATMs.
- The Final Rule will for the first time require some banks to designate assessment areas in geographies where they have no physical presence.

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Facility-based assessment areas

- Banks will continue to delineate what will now be called "facility-based assessment areas" where they have their main offices, branches, and other staffed or remote deposit-taking facilities that are open to the general public. § __.16(b).
- Large banks and limited purpose banks must designate facility-based assessment areas consisting of a single MSA, one or more contiguous counties within an MSA, or one or more contiguous counties in a nonmetropolitan area of a state.
- Intermediate and small banks can continue to use partial county designations.

Retail lending assessment areas

- **<u>Large banks</u>** will be required, for the first time, to establish “retail lending assessment areas” where they have concentrations of at least 150 closed-end home mortgage loans or at least 400 small business loans in two consecutive years. § __.17(c).
    - These are increases from the NPRM’s thresholds of 100 home mortgage loans or 250 small business loans.
- A large bank is exempt if more than 80% of its lending is within facility-based assessment areas.
- Retail lending assessments areas will consist of either:
    - The entirety of a single metropolitan statistical area (MSA), excluding areas already within a bank’s facility-based assessment area, or
    - All of the nonmetropolitan counties in a single state, excluding counties inside their facility-based assessment areas, aggregated into a single retail lending assessment area. § __.17(b).
- Only the product line(s) that trigger the delineation will be evaluated.
- Banks would be evaluated under the Retail Lending Test in these new assessment areas, but not other performance tests (i.e., Retail Services Test or Community Development tests).

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Outside Retail Lending Areas

- Large banks, intermediate banks, and small banks that opt into the new Retail Lending Test will be evaluated in the bank's "outside retail lending area" at the institution level.
- Lending will be evaluated if a bank's loans exceed a 15% major product line standard (i.e., the bank's loans in a particular product line comprise 15% or more of all loans).
- For intermediate banks and small banks that opt in, retail lending will be evaluated in the bank's "outside retail lending area" if 50% or more of lending is outside facility-based assessment area.

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Performance Tests and Standards

Performance Tests and Standards – Current Rule

- Large Banks
  - Lending Test
  - Investment Test
  - Service Test
- Intermediate Small Banks
  - Small Bank Lending Test
  - Community Development Test
- Small Banks
  - Small Bank Lending Test

New Performance Tests and Standards: Large Banks

Assets of at least $2 billion in the prior two calendar years.

- Retail Lending Test
- Retail Services and Products Test
- Community Development Financing Test
- Community Development Services Test

Additional requirements if assets of at least $10 billion in the prior two calendar years.

- Evaluation of digital and other delivery systems and deposit products.
- Evaluation of deposit products responsive to the needs of low- or moderate-income individuals.
- New data requirements for deposits, retail services, and community development activities.

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New Performance Tests and Standards: Intermediate, Small, and Limited Purpose Banks

- **Intermediate banks**
  - Retail Lending Test and the *status quo* community development test, with choice to opt into new Community Development Financing Test. § __.21(b)(2).
- **Small banks**
  - *Status quo* small bank lending test, with choice to opt into new Retail Lending Test. §§ __.21(b)(3), .29(a).
- **Limited purpose banks**
  - Tailored version of the Community Development Financing Test.

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Retail Lending Test

Application by bank size

- Large banks would be evaluated under this test in facility-based assessment areas, retail lending assessment areas, and at the institution level outside retail lending areas.
- Intermediate banks would be evaluated under the test in facility-based assessment areas, and also outside its facility-based assessment areas if the bank originates and purchases over 50 percent of its retail loans, by dollar amount, outside of its facility-based assessment areas.
- Small banks would be evaluated under the current lending test, unless they opt into the new Retail Lending Test.

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Retail Lending Test

- The following products will be evaluated under the Retail Lending Test:
    - Closed-end home mortgage loans
    - Small business loans
    - Small farm loans
    - Auto loans, but only if auto loans are a majority of the bank's lending .
- This is a change from the NPRM, which would have also included open-end home mortgage loans, multifamily loans, and auto loans in much broader circumstances.
- These products would be evaluated when they qualify as a "major product line"—generally, when a product comprises 15% or more of a bank's retail lending volume.

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Retail Lending Test Metrics and Benchmarks

- **Retail lending volume screen:** will assess a bank's dollar volume of retail lending relative to its deposit base, compared to other banks in each facility-based assessment area. (Appendix A, Section I.)
- **Distribution metrics and thresholds:** will individually evaluate each of a bank's major product lines, in each facility-based assessment area, retail lending assessment area, and outside retail lending area. (Appendix A, Sections II, III, IV.)
    - Separate evaluation of geographic distribution and borrower distribution for each product line.
    - Metrics will distinguish between different income levels and business and farm sizes
- **Benchmarks:** A bank's distribution metrics will be compared to corresponding market and community benchmarks.
- Performance ranges and performance thresholds for various conclusions (i.e., Outstanding, High Satisfactory, Low Satisfactory, Needs to Improve, Substantial Noncompliance).
- Banks will be assigned scores by product line, and those scores will be aggregated to determine the bank's rating, together with analysis of certain qualitative factors.

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Retail Services and Products Test

- Applicable to large banks.
- This test would remain predominantly qualitative, with certain quantitative measures incorporated.
- Would evaluate delivery systems, including branching, remote service facilities, and digital delivery systems. § __.23(b).
  - Evaluation of digital delivery systems would be required only for large banks with assets of over $10 billion; large banks less than $10 billion could request additional consideration.
- The credit and deposit products components of the proposed test would evaluate a bank's efforts to offer products that are responsive to the needs of low-and moderate-income communities. § __.23(c).
  - Evaluation of deposit products responsive to the needs of LMI individuals would be required only for large banks with assets of over $10 billion; large banks less than $10 billion could request additional consideration.

Community Development Activities

Community development definitions

The Final Rule incorporates aspects of the current interagency Q&A and includes eleven defined categories for community development activities. § __.13(b) – (l).

- Affordable housing
- Economic development
- Community supportive services
- Activities with MDIs, WDIs, LICUs, CDFIs
- Financial literacy
- "Place-Based" Activities
    - Revitalization or stabilization
    - Essential community facilities
    - Essential community infrastructure
    - Recovery activities that promote the recovery of a designated disaster area
    - Disaster preparedness and weather resiliency activities
    - Qualifying activities in Native Land Areas

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Community Development Credit

- Activities will receive full credit if they meet a “majority” standard (generally, if the majority of beneficiaries or housing units, or the majority of dollars, support the community development purpose). § __.13(a)(1)(i).
- Activities may also receive full credit if:
    - The activity has the “express, bona fide intent” of community development. § __.13(a)(1)(ii).
    - The activity is undertaken in cooperation with an MDI, WDI, LICU, or CDFI. §§ __.13(a)(1)(iii), (k).
    - The loan, investment, or service supports LIHTC-financed affordable housing. § __.13(a)(1)(iv).
- Banks may receive partial credit for loans, investments, or services supporting affordable rental housing in conjunction with a government housing plan, program, initiative, tax credit, or subsidy. § __.13(a)(2).
    - Credit will be in proportion to the percentage of total housing units in a development that are affordable to LMI individuals.

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Qualifying Activities and Illustrative List of Activities

- Currently, the agencies typically do not provide advance assurance that an activity is a qualifying community development activity.
- The agencies will establish and periodically update a publicly available, illustrative list of activities eligible for community development consideration. § __.14(a).
- The agencies will also establish a process for banks to request that the agencies confirm in advance the eligibility that specific activities qualify for community development consideration. § __.14(b).

Community Development Financing Test

- Applies to large banks and intermediate banks that opt in.
- Assessed at the facility-based assessment area, state, multistate MSA, and institution levels—but <u>not</u> in retail lending assessment areas.
- Banks can receive credit at the institution level for any qualifying community development activity.

Community Development Financing Test – Metrics and Benchmarks

- **Community development financing metric:** will measure the dollar value of a bank's community development loans and investments, relative to the dollar value of the bank's deposits.
  - In the numerator, the agencies will count new originations, purchases, and increased balances, as well as prior loans and investments remaining on a bank's balance sheet.
- **Community development financing benchmark:** a measure of community development financing activities by all banks.
- **Community development <u>investment</u> metric and benchmark** for banks with assets of $10 billion.
- The test also incorporates an evaluation of the impact and responsiveness of a bank's community development financing activities through the application of a series of qualitative factors set forth in § __.15(b).

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Community Development Services Test

- The proposed test would consist of a primarily qualitative assessment of the bank's community development service activities. § __.25.
- The Final Rule did not include the NPRM's proposal to use a metric to measure the hours of community development services activity per full time employee of a bank.

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Community Development Financing Test for Limited Purpose Banks

- Institution level-metric measuring a bank's volume of activities relative to its assets, § ___.26(f).
    - The numerator of the metric would be the dollar volume of qualifying community development loans and investments.
    - The denominator in this metric would be a bank's asset size, not its deposit volume (which is the denominator in the community development financing metric for large banks).
- The Final Rule incorporates new benchmarks that were not included in the NPRM.
- Option to have examiners consider community development service activities that would qualify under the Community Development Services Test.

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Strategic Plans

- The Final Rules maintains a strategic plan option as an alternative method for evaluation. § __.27.
- The Final Rule adopts the NPRM’s strategic plan proposal, with certain changes intended to provide clarity and flexibility.

Assigned Conclusions and Ratings

- In general, the agencies will assign conclusions for a bank's performance under the respective performance tests. The ratings will be "Outstanding," "High Satisfactory," "Low Satisfactory," "Needs to Improve," or "Substantial Non-compliance."
- The overall performance of a bank will be rated at the state, multi-state MSA and institution level as "Outstanding," "Satisfactory," "Needs to improve," or "Substantial non-compliance."
- The Retail Lending Test conclusion for a large or intermediate bank must be at least Low Satisfactory for the bank's overall rating to be Satisfactory or higher.

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Assigned Conclusions and Ratings, cont.

- **Effect of evidence of discriminatory or other illegal credit practices (§ __.28(d))**
  - The Final Rule does not adopt the NPRM's controversial proposal to permit downgrades of a bank's CRA rating based on virtually any illegal practice, even those unrelated to credit and the core purposes of the CRA.
  - The Final Rule instead generally retains the existing regulatory standard that permits a downgrade only for discriminatory or other illegal credit practices, although it is arguably broader in some respects.
- **Consideration of past performance (§ __.28(e))**
  - The agencies will consider a bank's past performance in assigning ratings.
  - If the prior rating was "needs to improve," the agencies may determine that a "substantial non-compliance" rating is appropriate where the bank failed to improve its performance with no acceptable basis for its failure.

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Data Collection and Reporting

- Data requirements for intermediate banks and small banks will remain unchanged.
- **Deposit data:** Large banks with assets of over $10 billion will have new data collection and reporting requirements for deposits data, including the volume of deposits at the bank aggregated at the county level based on the location of the depositor.
- **Assessment areas delineations:**
  - Large banks will be required to report assessment area delineations, including any retail lending assessment area(s).
  - Limited purpose banks that meet the asset size threshold for large banks will be required to report facility-based assessment areas.
- **Small business and small farm lending data:** Large banks will be required to collect, maintain, and report small business and small farm lending data.

Data Collection and Reporting, cont.

- **Auto loans:** If auto loans constitute a majority of a large bank's lending, the bank must collect and maintain specific auto loan data.
- **Retail services and products:** Large banks will be required to collect and maintain branch and remote service facility location data.
- **Digital and other delivery systems:** Large banks with assets over $10 billion, or those requesting consideration, must collect and maintain data on digital and other delivery systems.
- **Responsive deposit products:** Large banks with assets over $10 billion, or those requesting consideration, must collect and maintain data on responsive deposit products.

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Data Collection and Reporting, cont.

- **Community development financing data:**
  - Large banks and limited purpose banks that meet the asset size threshold for large banks will be required to collect, maintain, and report CD financing data.
  - Intermediate banks would also be required to collect and maintain CD financing data if they opt into the CD Financing Test.
- **Community development services data:** Large banks will be required to collect and maintain CD services data.

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Disclosure of HMDA Data by Race and Ethnicity

- For large banks that are HMDA reporters, the agencies will publish on the agencies' websites data concerning the distribution of home mortgage loans by income level, race, and ethnicity. §__.42(j)(2).
- The Final Rule states that this data would have no direct impact on the conclusions or ratings of a bank. §__.42(j)(4).
- However, it could lead to increased fair lending and redlining scrutiny.

The agencies’ original timeline

- The Final Rule was originally scheduled to become effective **April 1, 2024**; however, only a small number of provisions would have actually become effective on that date (e.g., facility-based assessment areas, online posting of public file).
- **Instead,** on March 21, the agencies delayed the effective date of those provisions until January 1, 2026.

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Litigation challenging the new rules

- On February 5, several trade associations filed a lawsuit seeking to enjoin the new rules (*Texas Bankers Assoc., et al v. Office of the Comptroller, et al*, No. 24-cv-00025-Z, N.D. TX).
- The lawsuit challenges several aspects of the new rules, including:
  - Creation of Retail Lending Assessment Areas and Outside Retail Lending Areas, because these would require evaluation of a bank's performance outside its "community."
  - Evaluation of aspects of deposit services and systems, because these are not "credit" covered by the CRA statute.

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Court grants preliminary injunction

- On March 29, the court granted a preliminary injunction that bars the agencies from enforcing the rules against the plaintiffs, and extending the effective date of the rules while the litigation is ongoing.
- The court determined that the plaintiffs have a substantial likelihood of prevailing on the merits of the case, a requirement for issuing a preliminary injunction.
- The court also found that compliance costs could result in "irreparable injury."
- Technically, the injunction applies only to the named plaintiffs in the suit – and there is uncertainty whether this will be extended to all banks nationwide.

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Potential Timeline

- **January 1, 2026:** Most of the Final Rule would become effective on 1/1/26, including new definitions, performance tests, new asset-size thresholds, data collection requirements, and appendices.
- **January 1, 2027:** The Final Rule's data reporting requirements would become effective 1/1/27, and annual reporting will be required every April 1 beginning on 4/1/27.

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Key Risks and Challenges

- Adapting to new assessment areas and products
  - Accurately breaking out the covered areas between facility-based, retail-lending, and outside retail lending will require aggregating lending data for the past few years and mapping it against MSA to identify qualified areas.
- Developing and executing on an implementation plan
  - Banks will need to conduct an individualized analysis of the impact of the Final Rule, and potentially implement a significant overhaul of their policies, products, systems, and procedures.
- Collecting and reporting both qualitative and quantitative data
  - Once the Final Rule is effective and updated policies, products, systems, and procedures are in place, banks will need to continue to collect, analyze, and report the data. Banks will need to conduct and carry out monitoring frequently so they can make any required program adjustments in a timely fashion.

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Transition to Final Rule

- The Final Rule does not include fixed start dates for exams under the new standards.
- Each agency will develop its own policies and procedures for conducting exams when both CRA frameworks apply.
- Prior to the applicability dates, banks must comply with the relevant provisions that remain in effect from the current rule.
- Consideration of Bank Activities
  - In assessing a bank's CRA performance, the agencies will consider any loan, investment or service that was eligible for CRA consideration at the time the bank conducted the activity. (§ __.51(c)(1))
  - The agencies will also consider any loan or investment eligible for CRA consideration at the time the bank entered into a legally binding commitment to make the loan or investment. (§ __.51(c)(2))

What Can Banks Do To Prepare?

- Assess the magnitude of changes required to comply with the new rules.
- Banks can take the following actions to position themselves for success:
  - **Evaluating Technology**: analyze the current-state capabilities of your systems to identify potential technology updates that may help streamline the process of capturing the new CRA data requirements.
  - **Identifying Scope**: assess your product offerings and areas of business (branch based and digital based) to determine the scope of impact for retail lending transactions.
  - **Gap Analysis**: evaluate covered areas, applications, and data collection practices against CRA requirements to determine areas needing updates to achieve compliance.

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Biography

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Brian is senior counsel at Pillsbury and former deputy superintendent at the New York Department of Financial Services, where he oversaw CRA and fair lending examinations of banks.

At Pillsbury, Brian's practice focuses on representing and advising banks, non-bank financial institutions, fintech companies, and other businesses on regulatory and compliance matters, with a particular focus on bank regulatory matters. He regularly advises banks and other regulated institutions on how to adapt to evolving regulatory requirements. Brian also counsels clients on compliance with regulators' cybersecurity, information technology and third-party risk management requirements.

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