CRA cheat sheet: New regime would look very different

By Brendan Pedersen

WASHINGTON — After nearly two years of anticipation, financial regulators unveiled a sweeping proposal Thursday to reform how they implement the Community Reinvestment Act.

The plan, released at a Federal Deposit Insurance Corp. board meeting, will overhaul CRA assessment boundaries, criteria for activities earning credit in CRA exams and how banks are scored overall for their performance. If finalized, the proposal would be the first significant update to the 1977 law in over two decades.

The proposal has been championed by the Office of the Comptroller of the Currency. Despite support from the FDIC, the Federal Reserve has been unwilling to sign on to the draft plan, raising concern about competing CRA regimes.

"The proposal would generate many benefits for the communities that banks serve, the advocates who support those communities, and the banks we regulate," Comptroller Joseph Otting said in a statement Thursday. "Above all, I believe these changes will encourage banks to lend and invest more in the communities that need it most."

The new framework would include a carve-out for banks with under $500 million of assets, allowing institutions below that threshold that are supervised by one of the agencies covered by the plan to decide if they want to opt in to the new CRA system.

"The proposal would ensure that small banks are not overly burdened by the need to overhaul their existing systems or collect and report extensive data to comply with the new framework," FDIC Chair Jelena McWilliams said at the board meeting.

The proposed changes to the framework are significant, so much so that OCC officials say that comparing future CRA investment to current levels will be “apples and oranges.”

Yet the issue has revealed sharp divisions. Banking industry groups and Republican lawmakers applauded the two agencies for advancing a plan, but consumer advocates immediately criticized it. House Financial Services Committee Chairwoman Maxine Waters, D-Calif., and other Democrats made the rare move of attending the FDIC board meeting in a show of their disapproval. FDIC board member Martin Gruenberg, meanwhile, cast the lone dissenting vote against the proposal.

"Providing greater certainty to bankers and community organizations as to whether proposed investments or loans would receive CRA credit is a commonly shared goal, although it poses challenges in practice," Gruenberg said. "The NPR before the FDIC board today would seek to address these issues. However it would do so in a misconceived, unworkable, and damaging way to CRA."

The draft is only a preliminary step. Regulators must now collect public feedback and weigh potential changes before finalizing any reform plan.

Here are key nuts and bolts from the proposal.

Assessment areas

At the core of the CRA are the geographic zones in which banks are required to invest. Historically, those areas have been tied to the physical components of financial institutions, namely offices, branches and ATMs.

But banks have long complained with increasing urgency that the reliance on physical branch locations is out of step with banking trends for large areas of the U.S. Internet-only banks may have a single corporate office but have deposits scattered all over the country.

In areas such as Utah, a high concentration of banks with limited or no branch operations means fierce competition among institutions to find opportunities for qualifying CRA investments. And areas without bank headquarters or branches, where customers still reside, are often ineligible for CRA investment of any kind.

50%-5%

The OCC and FDIC’s proposal would maintain in part the physical component of assessment areas while introducing a new "50%-5%" breakdown. If a bank receives more than 50% of its deposits from areas not tied to its physical locations — now termed “facility-based assessment areas” — the financial institution would be required to analyze the reported locations of its depositors. (OCC officials say that data would be reported to regulators in the form of ZIP codes.)

Any such zone found to have a concentration of more than 5% of the institution's deposits would be considered a new CRA assessment area, requiring the bank to invest in the area in order to achieve CRA compliance.

But determining the exact size and boundaries of the area would vary based on key factors, and the bank has some discretion to select its boundaries.

“The agencies would provide banks the option to choose the geographic level at which to delineate their facility-based assessment areas because the agencies believe that banks are in the best position to determine the areas that their facilities serve,” according to an OCC staff memo.

In an interview, OCC officials — including Otting — could not say with certainty how many banks would see their assessment areas altered by the proposed changes. Otting said that “at most, about 10 to 15 banks” would be “required to do more in markets that they’re not currently doing CRA activities today.”

“The vast majority of institutions will be able to take our equations into their geographic markets and apply them quickly,” Otting said.

But the proposal would go even further by allowing some banks, subject to certain conditions, to earn CRA credit outside of their assessments for the first time.

“The agencies recognize that there are certain communities of need where banks have a limited physical or deposit-taking presence,” the OCC said. “To help ensure that these areas are served, the proposed rule would allow banks to receive credit for qualifying activities conducted outside of their assessment areas in determining their bank-level ratings."

The move would open the door for banks to receive CRA credit while investing in remote areas of the country with little access to physical banking locations, such as tribal lands and poor, rural towns. But community groups and other activists are likely to seize upon the measure and accuse regulators of allowing banks to skirt their local obligations and potentially pursue more lucrative underwriting outside their communities.

List of common CRA activities

Bankers have also complained about the opaque nature of how their CRA performance is evaluated. It's never been entirely clear how different loans are scored and tallied.

The OCC and FDIC's proposal would change the process significantly.

For starters, the agencies' proposal would require regulators to develop a frequently updated list of commonly approved CRA activities. It would not be an exhaustive list but rather an "illustrative" list that banks would be able to use as a guide.

Regulators would also introduce a process in which banks could have projects approved for CRA credit before being underwritten, contrary to the current model of approving loans and receiving CRA credit after the fact.

Not units or dollars, but both

But the more dramatic changes would be the way in which CRA investments are scored.

Banks would be evaluated on the basis of both a total unit number of CRA-eligible loans and the total dollar amount lent to projects benefiting low-to-moderate-income communities. This was reportedly one of the chief areas of disagreement between the OCC and Fed, which was said to prefer an emphasis on total number of units.

"The one thing I've said from day one is, we have to look at units, we have to look at dollars," Otting said in the interview. "This is the way it's done today in a less formal way, where we look at a bank's performance in a market against their low-to-moderate-income activities in that market, and we're looking at the dollars in that market.

But community activists and others say increased emphasis on dollar amounts in CRA evaluations could lead banks to invest more of their resources in pricier, higher-margin loans in more expensive real estate markets.

Yet regulators counter that another change would offset such an outcome: focusing on CRA resources on helping low-to-moderate-income individuals, rather than communities.

"By emphasizing lending and services provided to or benefiting LMI individuals, the proposed rule closes a loophole that currently provides credit for loans to the wealthy and would avoid giving credit for activities that contribute to displacement and gentrification," the OCC memo said.

Simpler and more transparent CRA exams

Regulators are also proposing to streamline the structure of CRA exams.

Under the current regulatory framework, there are distinct tests for small, intermediate and large banks. With the new proposed framework, there would be only one test for banks, although banks with less than $500 million in assets will have the option to opt out and remain in the old framework.

As for the test itself, bankers will be able to see published versions of the equations that CRA examiners use to calculate evaluations.

The tests would be broken down into two parts: The “impact” portion would focus on total number of dollars invested, while the lending distribution portion would focus on number of units.

With the new framework, regulators would also release the required benchmarks to achieve satisfactory CRA activity. If a bank’s CRA lending constitutes 10% of 15% of its retail domestic lending in an area, it would achieve a rating of “outstanding.” If that ratio was 5% to 10% the bank would receive a “satisfactory” score.

For lending distribution, the test would be twofold. Regulators would assess the number of loans to low-to-moderate-income individuals, small businesses and small farms. Then, the test would gauge the geographical spread of loans in specific areas considered low-to-moderate-income.

CRA credit for longer-running investments

But perhaps the most significant change to the evaluation process would be the way in which CRA investment is scored over time. Currently, CRA is scored on a three-year basis, meaning that investments older than three years do not count toward credit.

With the proposed reform, however, regulators would throw out the three-year time frame and instead calculate CRA investment on an average, ongoing basis.

Otting argued that under the current framework, banks' approach to CRA credit becomes more about checking a box than actually investing new dollars in their communities.

“What we've tried to do with the modernization is, we'll give banks credit for what they have on their balance sheet on an average basis,” Otting said. “Meaning you bought those loans or you created those loans? You had them on your balance sheet? They were there for the three-year period. And then they're there for the next three years. What we’re looking at is aggregation.”