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SPECIAL FEATURE

Treasury Recommends CRA Modernization

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The Treasury Department has recommended that federal banking regulators significantly update how they implement the Community Reinvestment Act (CRA) to reflect sweeping industry changes and serve communities better. The next move is up to the three federal banking agencies.

Under the new leadership of Joseph Otting, the Office of the Comptroller of the Currency (OCC) has made modernizing CRA a top priority, which it has promised to start soon by publishing an advance notice of proposed rulemaking (ANPR), perhaps in concert with the Federal Reserve Board (FRB) and the Federal Deposit Insurance Corporation (FDIC). CRA policies are normally set jointly by the three banking agencies to promote consistency. After the ANPR is published and public comments are received and reviewed, a proposed rule would be the next step and then, following another round of comments, a final rule.

Under CRA, banks have an affirmative and continuing obligation to serve their entire communities, including the low- and moderate-income (LMI) neighborhoods and people, consistent with safety and soundness. The OCC, FRB and FDIC examine banks’ performance, publish ratings, and consider those ratings when banks apply to acquire or merge with other banks or to open new branches. CRA has been a powerful motivation for banks’ investments and loans for affordable housing, community development, home mortgages, small business and farm loans, and consumer services.

The CRA statute is 41 years old but also brief and broad, so while Congress is unlikely to take action, the banking agencies do have considerable regulatory discretion. Nevertheless, implementation of CRA has fallen far behind fundamental changes to banking and communities. The last major regulatory overhaul was completed in 1995, at

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the dawn of interstate banking and long before the emergence of Internet banks and mobile banking services, the growth of nonbank mortgage and small business lenders, and recent challenges, opportunities and practices in affordable housing and community development.

The Treasury report, in the form of a memorandum to the banking agencies, considers these changes as well as the complexity, narrowness, and ambiguity with which the agencies implement CRA regulations.

Assessment Areas

CRA ratings are primarily based on the "assessment areas" (AAs) surrounding a bank's branches. This system works well for community banks that serve one or a few AAs. However, the largest banks can have hundreds of AAs, complicating how a bank meets its CRA obligations and how an examiner evaluates performance, and they serve customers well beyond those AAs.

Meanwhile, an Internet bank or a credit card bank might operate nationwide without having any physical branch at all, in which case it designates a single AA where it is chartered, a decision often driven by favorable state laws. In these cases, AA designations fail to capture significant banking activity. Areas where many capable banks have AAs have become CRA hot spots while other places are CRA deserts. In particular, smaller metropolitan and rural areas tend to get less attention because they naturally generate fewer deposits. These disparities are reflected in the availability of financing or the pricing of loans and investments, such as for low-income housing tax credit (LIHTC) developments.

The Treasury report "advocates for a framework that not only includes areas where the bank is physically located, but also LMI communities outside of where the bank has its physical footprint, and in areas where the bank accepts deposits and does substantial business. Treasury believes that an approach that would allow banks to address needs that overlap with their entire customer base would improve the effectiveness of the CRA statute."

Examination Clarity and Flexibility

Unlike federal spending programs or capped tax incentives like LIHTC and new markets tax credits, CRA is not a finite resource; banks will do more if they can get favorable consideration. However, a large bank with 10 to 20 performance targets in each of numerous assessment areas will find it hard to go the extra mile to support activities that will not or might not qualify for CRA consideration. Communities miss out when, as Treasury finds, banks cannot know whether an activity will be considered until they are examined years after financing decisions have been made.

Policy guidance is often unclear or is applied inconsistently. Regulators sometimes treat the same activities differently. For example, the FRB treats letters of credit, such as those to support tax-exempt bond financing, as equivalent to loans, but the OCC devalues them as only like loan commitments. Eligibility for other activities is decided by individual examiners. For example, to get credit for financing naturally occurring affordable rental housing, a bank must present a market analysis showing the likelihood that LMI renters will occupy the housing–adding cost and uncertainty. Treasury also points out that CRA treats long-term investments more favorably than long-term community development loans.

Treasury recommends that the range of CRA-eligible activities be expanded, such as infrastructure serving LMI people and neighborhoods. As the delivery of consumer services has expanded to digital delivery channels, including Internet banking and mobile technology, CRA's service test remains focused

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primarily on the presence of branches in LMI neighborhoods. Treasury recommends that the service test better reflect the effects of technological innovation.

Similarly, while CRA requires some important judgments, too many elements are excessively subjective. Concepts like "responsiveness," "innovativeness," and "complexity" have defied clear definition. In addition, a bank's "performance context"–its business strategy and capacity as well as each community's needs and opportunities–is important in analyzing CRA performance. Treasury recommends revisiting assessment area definitions to reflect the realities of a changing banking industry. The banking agencies' research and policy staff could help develop the performance context in advance of examinations.

Treasury also finds it is hard to know what makes a bank's performance outstanding, satisfactory or insufficient. Again, a certain degree of judgment is appropriate, but making better use of lending data–especially for home mortgages and small business and farm lending–could greatly clarify performance benchmarks and simplify evaluation while still respecting that banks have different business strategies and communities present diverse needs and opportunities.

Inconsistent examiner staffing is also problematic. The agencies do not have dedicated CRA specialists, so examiners responsible for other compliance matters (e.g., anti-money laundering) or safety and soundness are tasked with CRA reviews. It is hard for generalists to master the nuances of CRA, let alone the ever-changing practice of affordable housing and community development.

Banks can choose to establish their own CRA strategic plan and be evaluated against customized and approved performance benchmarks, but few banks have chosen this route. Treasury notes that the required community consultations are too cumbersome for banks with hundreds of assessment areas; the scope of strategic plan objectives differs little from those under a traditional exam; and amending a strategic plan if conditions change introduces considerable uncertainty.

Examination Process

Treasury also focused on seemingly mundane, yet important administrative elements of CRA exams. The time to conduct and publish CRA ratings has become excessively long. The most recent year covered by a performance rating for any of the six largest banks, comprising almost half of all U.S. domestic bank assets, was 2012. These delays provide insufficient feedback to banks and the public.

Not all AAs receive the same scrutiny in CRA exams. AAs that generate the most deposits in each state get a full-scope review, which includes both such quantitative factors as loan counts, volume and distribution, plus qualitative factors like responsiveness and impact. Most AAs, however, receive only a limited scope review of quantitative elements. Treasury notes that some stakeholders say this practice can effectively limit the attention that rural communities receive.

CRA Performance Ratings

Although CRA is not itself a consumer protection law, evidence of discriminatory or other illegal credit practices can result in a CRA rating downgrade. Treasury recommends that CRA downgrades should be based only on matters connected to CRA performance, such as fair lending, and that remediation be considered in downgrade decisions. Treasury also recommends that CRA ratings not be delayed pending consumer compliance investigations, but that a subsequent adverse finding be attached to the CRA performance evaluation as an addendum.

An unsatisfactory CRA rating usually blocks a bank's application for a merger, acquisition or a new bank

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branch. Late last year, OCC decided to provide exceptions based on certain factors, including steps the bank has taken to remediate the problem and whether, say, opening a new branch would improve service to LMI communities. Treasury recommends that FRB and FDIC adopt similar policies.

Conclusion

CRA is among the most consequential federal policies for affordable housing, community development and LMI consumers. The Treasury report effectively kicks off what promises to be the most far-reaching changes to CRA in a generation. ❖

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