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What Commenters Have To Say About Proposed CRA Updates

By **Warren Traiger and Caroline Eisner** (April 8, 2019)

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Finally, almost a decade after announcing a joint effort to modernize the Community Reinvestment Act, the prudential regulators have signaled that revisions are in the offing. Over the last two months, representatives from the Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation and Federal Reserve have each indicated their willingness to work together to revise the rules that implement the CRA.

Renewed deliberations began last autumn, when the OCC published an advanced notice of proposed rulemaking, or ANPR, that solicited answers to 31 questions about the CRA. In response, national- and state-chartered banks, trade associations, community advocates, representatives of federal, state and local government, and others submitted approximately 1,500 comments. The regulators are reportedly meeting this month to begin formulating a proposed rule, and the OCC and FDIC have suggested that a modernization process that includes the Fed could be completed within a year.

Our firm reviewed approximately 1,500 comments to the ANPR, which included the views of nearly 500 community advocates, more than 200 banks (about two-thirds of which were received from institutions not regulated by the OCC), approximately 120 trade associations, as well as approximately 40 governmental entities ranging from members of Congress to state banking regulatory agencies to city mayors. The comments provide valuable insight into what changes these various constituencies feel are needed.

Commenters Agreed That the Geographic Boundaries for CRA-Qualifying Activities Need Reform

There was wide agreement that the current rules, which essentially limit CRA assessment area delineation to the areas surrounding a bank's physical locations, were outmoded. The discussion affects not only how to draw the boundaries, but whether geographic boundaries are still relevant given technological innovation. Consensus seems to favor a replacement that is flexible enough to accommodate various bank business models while supporting expanded community access to banking services.

Most banks, along with community advocates and government entities, agreed that brick-and-mortar branches should continue to be a factor in what constitutes a bank's assessment area. Federal Reserve Board Governor Lael Brainard stated recently that branches remain an important venue for banks to engage with their communities despite the growing availability of digital channels for providing financial services. Several ANPR comments from municipal officials stressed the importance of branches for low- and moderate-income, or LMI, individuals for access to loans and banking services, a sentiment echoed by FDIC Chairman Jelena McWilliams in a recent speech.

A number of banks, community organizations and government entities noted that the presence of a bank branch acts as an anchor institution around which business districts are developed, and that a bank's investment in a community through a branch can often catalyze private market investment.

Overall, the position of banks largely turned on their various business models, including the extent of any branch network and where deposits are taken and services provided. Branchless banks generally supported a flexible approach to delineating assessment areas that would consider where the bank does business, rather than just where it is located. One approach, also endorsed by other banks, would add a deposit sourced-based component to delineation that would enable banks to direct CRA activities to underserved or unserved areas without abolishing the branch-centric model.

Currently, the regulations generally provide that CRA consideration is appropriate for out-of-assessment area activities only if a bank meets CRA needs within its assessment areas. In a recent speech, Brainard discussed enabling banks to have different assessment areas for retail and community development activities. Such an approach could thread the needle between retaining the branch-centric model and opening up wider areas for CRA qualifying activity, including CRA deserts.

Not All Agreed That the List of CRA Activities Should Be Expanded

Banks almost uniformly advocated for expanding CRA consideration to a greater variety of activities. But their enthusiasm was not echoed by community advocates. Some such organizations were not opposed to expanding the list of eligible activities, but only to the extent that a bank could demonstrate that the activities provide a direct benefit to LMI households in its assessment area.

Several government entities emphasized that the original purpose of the CRA was to combat redlining in LMI neighborhoods. They stressed that although volunteer work, for example, is certainly commendable, it is not a substitute for strong financial services and investment. They expressed that the CRA will be less effective in channeling resources to LMI communities if examinations give favorable consideration to activities that do not address the lack of access to banking or community development needs.

Stakeholders Disagreed on Treating the Primary and Secondary Mortgage Markets Alike

Community advocates noted that a bank's loan purchases and loan originations should not receive equal treatment under the CRA when evaluating a bank's lending performance, instead arguing that originations should be valued more highly than purchases. These organizations asserted that it is much more impactful to originate a loan directly, rather than to purchase one. They noted that while there are some instances where purchasing a loan might serve a purpose, such as from a community development financial institution or mission-driven credit union to allow them to make more loans, such instances should receive a case-by-case evaluation for CRA consideration.

Banks, however, wanted to maintain the current CRA approach to give equal weight to loan purchases and originations. Banks noted that their business models affect which loans they can originate, and accordingly, consideration should be given for the various ways in which a bank chooses to serve the financial needs of their communities.

This split persisted in the discussion of providing consideration for loan-backed securities. Community advocates stated that mortgage-backed securities provide less of a benefit to borrowers than direct lending, and less of a benefit than other types of investments such as low-income housing tax credits, equity equivalent investments, grants and deposits. Bank commenters, however, generally noted that mortgage-backed securities enable result in greater capital and liquidity, facilitating the origination of additional loans and stabilizing the mortgage market.

A Metric-Based Performance Measurement System is Hotly Debated

The OCC solicited comments about whether to incorporate a benchmark metric for CRA performance, to be based on a ratio of the dollar value of the bank's CRA-qualified lending, investment, and service activities as a percentage of its domestic assets, deposits or capital. In theory, the method would signal whether banks are in compliance with the CRA and would pass their next examination. Although some commenters recognized the merits of a metric-based framework in increasing evaluation transparency and consistency, they still cautioned against a uniform approach that relegated CRA to a mathematical formula.

Commenters from across the spectrum stressed that banks should be evaluated on the quantity and quality of their activities within their communities, and noted that a metric-based concept cannot capture the depth and nuance needed to respond to local needs. Banks and community advocates warned that if the CRA evaluation and scoring process transitioned to a metric-based analysis, it would incentivize banks to seek out the largest financial transactions — likely at the expense of small dollar transactions, community development loans and loans that require more complex underwriting.

Brainard discussed the use of metrics as a means to evaluate CRA performance, but stressed the need for better data to support such an undertaking. She articulated that a metrics-based approach could "provide the improved clarity and ex ante predictability that banks seek," but would require more and better data than is currently collected under the CRA on small business, small farm, and community development loans.

Community advocates reacted most negatively, arguing that a metric-based approach will remove the role of communities in CRA, with one organization going so far as to refer to it as "a poison pill for any package of CRA regulatory change." Some community organizations stressed that a metric-based examination would perpetuate the CRA desert status of rural areas and smaller cities.

A number of governmental entities were also unsympathetic to a metric-based approach, indicating that it would not resolve concerns about the lack of consistency, objectivity and transparency in CRA evaluations. Instead, they dismissed the metric as a solution in search of a problem, given that 98 percent of banks receive passing CRA grades of outstanding or satisfactory. These entities proposed tightening CRA rules to make it harder for banks to receive a passing grade.

Notwithstanding the generally unenthusiastic reaction to a metric-based performance evaluation, commenters were nearly all aligned in advocating for increased transparency and consistency in CRA evaluations.

Conclusion

Despite their varying opinions on modernizing CRA regulation, banks, community advocates and government entities across the board are aligned in their support for fostering community and economic development. Banks and their trade groups seek a clear but flexible regulation that acknowledges that institutions of different sizes and business strategies require different CRA rules. Community advocates and government entities stressed the importance of incorporating public input and local accountability in serving the economic and development needs of communities. But nearly all commenters agreed that the three agencies, which historically have acted in tandem in CRA enforcement, should continue to collaborate and ensure that all banks are subject to the same set of regulations, whatever their charter and whoever their regulator.

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