Changes on the Horizon for the Community Reinvestment Act

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Executive Summary

The Community Reinvestment Act (CRA) was enacted over 25 years ago and creates an affirmative obligation on banks to provide fair access to capital and banking services to the communities that they serve, including low-income and moderate-income (LMI) neighborhoods, by reinvesting in these communities and providing equitable access to banking services. The CRA is unique in its potential to remedy America's history of exclusionary and discriminatory lending practices, which have denied minority communities and LMI communities with access to tools for wealth creation. Critics of the CRA, however, note numerous flaws and missed opportunities in its implementation including, but not limited to, its vague directive, its failure to explicitly address persistent racial inequalities in lending practices, its failure to meaningfully address the growing wealth gap in America, and its evaluation system—which many perceive to be too lenient in its assessments of whether banks have met the needs of their communities under the CRA. A voluminous set of changes to the CRA are pending, with the goal of modernizing it to keep pace with fundamental changes in the financial services industry and to otherwise better achieve the CRA's purpose. However, the proposal's failure in tackling persistent racial inequities in access to capital and its failure to address the "grade inflation" enjoyed by banks, limits the likelihood that the amended CRA will spur aggressive action from banks to fully meet the needs of the underserved in their communities.

PART ONE

History of Redlining

As discussed during April De Simone's presentation called "Designing for Democracy" at the 2022 Annual Meeting of the American College of Mortgage Attorneys, she explained that, following the Great Depression, the United States government deliberately discriminated against African Americans and other minorities through its Home Owner's Loan Corporation and other agencies, when allocating fed-eral resources to relieve struggling homeowners, stabilize neighborhoods, and create a safety net for the working class. Through the practice known as "redlining," federal governmental agencies designated minority communities as high-risk and less-desirable areas for investment, based largely on a community's racial demographics.[1] The foreseeable effect of these discriminatory practices was to entrench these minority communities in poverty and divestment of resources—disparities which persist to this day.

CRA Purpose and Intended Beneficiaries

Enacted in 1977, the CRA is part of several Civil Rights Era laws, including the Fair Housing Act of 1968, the Home Mortgage Disclosure Act of 1974, and the Equal Credit Opportunity Act of 1974, designed to prohibit discrimination, disclose exploitative practices and promote fairness in the housing and finance sectors.[2] Specifically, the CRA was intended to redress the inequities that resulted from redlining and other discriminatory practices, including the unfair practice of taking deposits from LMI communities but not making any meaningful investments or lending activities (i.e. reinvestments) into those communities. The CRA is unique in the affirmative obligation it imposes on banks, consistent with the bank's safe and sound business practices, to meet the needs of the communities in which they operate, including LMI neighborhoods. The CRA, however, is "race-blind" in its approach and does not require banks to eliminate racial disparities in their banking practices. Consequently, the CRA misses an opportunity to directly redress America's legacy of discriminatory lending practices, which have disproportionately affected minority communities.[3]

Although it has been difficult to ascertain the effectiveness of the CRA, as no single regulatory agency is responsible for evaluating its overall effectiveness, it is generally believed that CRA has resulted in an increase in lending to LMI communities.[4] However, these gains are arguably insufficient given the prevalence of economic inequities which persist in the decades since the CRA was enacted.

Implementation of the CRA

The CRA is administered jointly by three federal agencies (collectively, the "Agencies")—the Office of the Comptroller of the Currency (with regard to national banks), the Federal Deposit Insurance Corporation (with regard to state-chartered banks and savings banks whose deposits are FDIC insured), and the Board of Governors of the Federal Reserve System (with regard to state chartered banks that are members of the Federal Reserve System and to bank holding companies). In the past, the Agencies have separately issued regulations creating inconsistencies in how the CRA is administered by the respective Agencies. Now, however, the Agencies are working collaboratively, and the forthcoming amendments to the CRA will be issued jointly by the Agencies.

Banks subject to the CRA are evaluated in the context of the performance of their peer institutions, based on their size as small, intermediate, or large banks, and the needs of their communities. Small banks are categorized as having less than $346 million in assets and must meet a lending performance standard. Large banks are categorized as having assets in excess of $1.384 billion and are evaluated under three separate performance tests for their retail and community development loans, qualified investments, and retail and community development services. Intermediate banks are categorized as having assets between $346 million and $1.384 billion and must meet a performance standard that combines lending and community development. Warehouse and limited purpose banks, which engage in incidental lending or offer a narrow product line, respectively, are evaluated under a standalone community development test. As an alternative to the above size-based performance test, a bank of any size can chose to be evaluated under a strategic plan, prepared by such bank with community input, subject to approval by bank regulators, that sets forth measurable, annual goals for lending, service, and investment activities. Notably, the CRA does not apply to credit unions, insurance companies, nonbank mortgage companies, or other nonbank financial intuitions, including many large "FinTech" companies, regardless of their size.[5]

CRA evaluations currently consist of three tests: the lending test, the investment test, and the service test. The lending test, which is regarded as the most important of the three tests as its score is more heavily weighted, evaluates a bank's retail lending activities, including the volume and type of loans extended, taking into account geographic and income distribution. The investment test measures a bank's community investment projects and activities, including those that promote affordable housing, community services, economic development, and other activities that revitalize and stabilize underserved communities. The service test examines the availability of bank branches and low-cost checking accounts in the assessment area.[6]

Currently, bank examinations under the CRA focus on a branch-banking model, where banks are primarily evaluated on the geographic areas where they maintain their main office, branches, ATMs, and where substantial portions of their loans are originated or purchased. However, given the prevalence of online and mobile banking, the Agencies realize that this historic focus on branch locations no longer adequately captures the geographic territory where a bank conducts its business.

Accountability Under the CRA

As a result of prior amendments to enhance the effectiveness of the CRA, the Agencies are now required to publicly disclose a bank's performance under the CRA examination and the basis for the bank's rating. Such disclosure allows community development professionals and other stakeholders visibility into which banks are meeting their CRA requirements and how a bank's performance compares to its peer institutions. In addition to reputational harm that can result from a bank's failure to meet its CRA requirements, the Agencies are required to take into account a bank's CRA rating when making decisions on whether to permit a bank's expansion, merger, or other business growth activities which are subject to regulatory approval. Consequently, the failure of a bank to perform adequately under the CRA could result in significant adverse economic consequences for the bank. However, in practice, banks very rarely receive a failing score, and the threat of regulatory restrictions in connection to inadequate performance under the CRA is mostly theoretical.

In 2022, for example, 96% of banks received one of the top two (out of four) ratings (i.e., Outstanding or Satisfactory), which means they are not at risk of any adverse outcomes in connection with their CRA performance; only 3% of banks received a Needs Improvement score; and 0%—when rounded—of banks were identified as being in Substantial Noncompliance under the CRA. Moreover, researchers note that the Agencies' tendency to give banks passing marks has only increased with time.[7]

This very high passage rate for banks is puzzling given the vast discrepancies in access to capital that continue to exist for LMI neighborhoods, the prevalence of "banking deserts" (areas further than 10 miles from a bank branch), and the persistent racial wealth gap.[8]

Additionally, with nearly all bank's receiving a CRA rating of satisfactory or better, it is not clear which banks should be doing more to improve their practices to better serve LMI communities. Furthermore, as banks define their own "community assessment area"—based largely on the location of their physical footprint, the needs of communities which lack bank branches, or which primarily utilize online and mobile banking, may not be adequately incorporated into a bank's CRA evaluation, regardless of the volume of deposit a bank might receive from such communities.

PART TWO

Notice of Proposed Rulemaking

In May 2022, the Agencies issued a Notice of Proposed Rulemaking (NPR) to strengthen the CRA, to create greater variety in the ways that banks are assessed and to adapt the CRA to changes in the banking industry, particularly in connection with mobile and online banking.[9] If adopted, these changes will be the first large-scale revision to the CRA in over 25 years. Some of the proposed changes to the CRA noted in the NPR include the following[10]:

- Revising the community development definitions and concepts (including Affordable Housing, Economic Development, Community Supportive Services, Place-Based Activities, Mission-Driven Financial Institutions, Financial Literacy, and Activities on Native Land Areas) to clarify and expand CRA eligibility for a broad range of community development activities;
- Providing a non-exhaustive exemplary list of activities that qualify for CRA consideration and providing banks with an opportunity to confirm CRA eligibility in advance of undertaking such activities;
- Providing new standards for whether an activity has a "primary purpose" of community development and therefore would qualify for CRA consideration;
- Providing clearer standards for how the Agencies' review of community development activities will impact a bank's evaluation;
- Supplementing the existing facility-based assessment areas (i.e., areas where banks have their main office, branches and other deposit-taking facilities), with an additional requirement for large banks to include within their assessment area one or more Metropolitan Statistical Areas (MSAs) or metropolitan divisions, or one or more counties within an MSA, metropolitan division, or the nonmetropolitan area of a state;
- Requiring large banks to designate retail lending assessment areas in locations where they originated at least 100 home mortgage loans or 250 small business loans;
- Requiring loans outside of a facility-based assessment area and retail lending assessment area, as applicable, to be evaluated on an aggregate basis;
- Evaluating a bank's qualified community development activities in each of its facility-based assessment areas, while also providing consideration for a bank's qualified community development activities which occur outside of its facility-based assessment areas;
- Adjusting the thresholds for the bank-size categories such that large banks would have assets in excess of $2 billion, intermediate banks would have assets in excess of $600 million but less than $2 billion, and small banks would have assets up to $600 million;
- Tailoring the performance test to a bank's size whereby large banks would be subject to all four tests (Retail Lending, Retail Services and Products, Community Development Financing, and Community Development Services), small banks would be evaluated under the current lending test, and intermediate banks would be evaluated under the Retail Lending Test and the current community development test or, at an intermediate bank's option, the new Community Development Financing Test;
- Requiring the inclusion of a bank's subsidiaries in its CRA evaluation;
- Assigning ratings for a bank for each applicable performance test at the assessment area level, as well as the state, multistate MSA, and institution levels, using five categories (Outstanding, High Satisfactory, Low Satisfactory, Needs Improvement, and Substantial Noncompliance), which would then roll-up into overall final ratings of a bank using the four statutorily required ratings of Outstanding, Satisfactory, Needs Improvement, and Substantial Noncompliance;
- Standardizing retail lending evaluations using retail lending metrics, benchmarked performance standards, and specific thresholds based on data specific to each assessment area;
- Establishing standards to determine when home

mortgage loans, multifamily loans, small business loans, and automobile loans would be considered a major product line of a bank and subject to review in connection with the needs of LMI communities;

- Aligning the definition of "small business" and "small farm" with the Consumer Financial Protection Bureau's proposal under Section 1071 of the Dodd-Frank Act (which uses a max threshold of $5 million in gross annual revenue);
- Developing a Retail Services and Products Test for large banks to determine how well accessible branch-based and digital services are available to LMI communities and whether credit and deposit products are responsive to the needs of LMI individuals, small businesses, and small farms;
- Developing a Community Development Financing Test that would consist of a community development financing metric (evaluating both loans and investments together), standardized benchmarks and an impact review;
- Developing a new Community Development Services Test which, for large banks, would measure the average hours of community development service activities conducted per bank employee, evaluate the community development service activities across a greater number of geographic areas, and include a greater number of activities that would qualify under community development services; and
- Tailoring data collection requirements to a bank's size, including limiting certain data collection to only large banks.

While the foregoing list is not an exhaustive list of all the proposed changes contained in the NPR, it does illustrate some of the complexity and depth of the proposed revisions.

Comments to the Proposal

The Agencies provided a three-month window to receive comments to the NPR from the public, which ended August 5, 2022. During that time, hundreds of comments were provided by industry groups, community organizations, individual practitioners, and a plethora of other stakeholders.[11] Generally, there appears to be support for both the revisions set forth in the NPR and its goal to modernize the CRA to be more responsive to current banking practices. However, several stakeholders have addressed pointed concerns and frustrations with what they perceive to be missing from the NPR.

For example, several commentators suggest that an amendment to CRA should explicitly consider racial disparities when evaluating a bank's performance, as the CRA's current focus on serving the needs of LMI communities fails to address persistent racial inequities in the availability of bank products and services to underserved African Americans. As one study concluded from looking at 2018–19 homebuyer mortgages reported in Home Mortgage Disclosure Act data, 30.2% of mortgage loans were to LMI borrowers and, of that share, only 32% of the loans went to borrowers of color. Although Black households comprised 17.9% of existing homeowners in LMI neighborhoods, they only received 13.1% of homebuyer mortgage loans. While LMI neighborhoods and neighborhoods of color experience overlap, many people of color remain underserved, and more is needed to address racial disparities in the banking system.[12]

Another well-founded critique of the CRA, which is not addressed by the NPR, is the Agencies' apparent tendency towards "grade inflation." Although the NPR sets forth numerous revisions to the performance tests which are designed to create a more inclusive and comprehensive evaluation process, there remains significant concern that it is far too easy for a bank to satisfy its CRA obligations. Without a more varied distribution of examination scores, the CRA fails to equip consumers, community development practitioners, and other stakeholders with pertinent information regarding which banks are excelling in their CRA performance and which banks are underperforming, in contrast to their peers.[13] Indeed, if there is no credible threat that a bank will receive a "failing"—or even a below-average—score in its CRA examination, the effectiveness of the CRA to incentivize banks to fully meet the needs of LMI communities is significantly diminished.

PART THREE

Conclusion

Although the period for public comments to the NPR has passed, the conversations around how best to modernize the CRA to better achieve its goals remains ongoing. The forthcoming amendments to the CRA represent a tremendous opportunity for banks to aim higher in their efforts to meet the needs of underserved communities and to advance solutions that redress the vestiges of discrimination and racism in America's banking and finance industries.

The views and opinions expressed in this article are those of the author only and do not necessarily reflect the views or positions of any entities they represent or are associated with.

Endnotes

1 Richard Rothstein, The Color Of Law: A Forgotten History Of How Our Government Segregated America (2017).

2 Peter Conti-Brown & Brian D. Feinstein, Banking on a Curve: How to Restore the Community Reinvestment Act, HARV. BUS. L. REV., Nov. 30, 2022, https://ssrn.com/abstract=4227321.

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13 Peter Conti-Brown & Brian D. Feinstein, *Banking on a Curve: How to Restore the Community Reinvestment Act*, Harv. Bus. L. Rev., Nov. 30, 2022, https://ssrn.com/abstract=4227321.