Insight

A New Proposal for the Community Reinvestment Act

THOMAS KINGSLEY | DECEMBER 17, 2019

Executive Summary

- The Community Reinvestment Act (CRA), a 1977 law designed to promote financial inclusion by requiring banks to provide services to low- and middle-income communities, has not been meaningfully updated in decades and does not support electronic banking.
- The CRA is administered by three agencies – the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), and the Federal Reserve (Fed) – and while the OCC has been remarkably eager to champion reform without the other two agencies, the FDIC has recently joined it in a draft reform proposal.
- The reform would encourage banks to provide more targeted support to low- and middle-income individuals regardless of where they live, although some contend the changes would allow banks to invest only in the most lucrative communities.

Introduction

The Community Reinvestment Act (CRA) was passed by Congress in 1977 to prevent banks from withholding loans or general banking services to individuals from low-income areas, a practice known as "redlining." The CRA is therefore the bedrock of financial inclusion initiatives underpinning the provision of banking services to population segments banks might otherwise deem unprofitable. The CRA architecture is also enormously important to banks, as good performance in the annual assessment leads to rewards in the form of "points" that banks can "spend" on desirable activities such as issuing new charters, opening new branches, relocating branches, consolidating, and embarking on mergers and acquisitions. For more information on the CRA, see the American Action Forum's (AAF) primer here.

Despite the importance of the CRA, it has not received a fundamental update since implementation and does not account for online banking – or even interstate banking. In August 2018 the Office for the Comptroller of the Currency (OCC) released an Advanced Notice of Proposed Rulemaking (ANPR) requesting comment on a proposed minor refresh of the CRA. For more information on this ANPR, see AAF's explanation here. What made this proposal slightly unusual was that the OCC is only one of the related agencies; banks are assessed by either the OCC, the Federal Reserve (Fed), or the Federal Deposit Insurance Corporation (FDIC), and it is far more typical for all the relevant regulatory agencies to embark on reform jointly.

One year on, the FDIC has joined the OCC in its modernization effort, releasing on December 12 with the OCC a joint proposal to modernize the CRA that builds on the over 1500 responses to the OCC's ANPR and a year of other nationwide outreach. The primary conclusions of this this research were, unsurprisingly, that "the current CRA framework has not kept pace with changes in banking or technology and that the CRA regulations and guidance have become cumbersome, outdated, and complex."

A New Proposal

The joint proposal would so radically revise the CRA that OCC officials have stated that comparing past and future CRA regimes is to compare "apples and oranges." Here are the most significant reform proposals.

Small bank exemptions

In line with general regulatory relief for smaller banks under S.2155, the Economic Growth, Regulatory Relief, and Consumer Protection Act, the new CRA would provide exemptions for banks with less than $500 million in assets, below which participating in the new regime would be optional for those banks. As FDIC Chair Jelena McWilliams noted, "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." Rather than a blanket one-size-fits-all policy for financial-services regulation, it is encouraging to see a continued effort to tailor existing regulation in line with the principle, articulated by Fed Vice Chairman Randal Quarles, that "the character of regulation should match the character of a firm."

A new approach to assessment areas

The most significant criticism of the CRA has always been its reliance on both geography and the physical locations of bank branches, distinctions that have become increasingly less relevant in a world of online banking, where some banks no longer have a physical presence. Worse, areas that do not have a physical banking presence may not currently be eligible for CRA investment at all. The importance of this geographic component in CRA assessments would be diluted by the new proposal, which establishes a "50 percent – 5 percent" rule. If a bank receives more than 50 percent of its deposits from areas not directly linked to the bank's physical locations, as determined by zip code, the bank must then investigate to see whether any of those locations have a concentration of more than 5 percent of the bank's deposits. If so, that area becomes a new CRA assessment area, requiring the bank to become CRA compliant. It is worth noting however that the physical presence of bank branches will remain an important element of the CRA assessment in addition to these new assessment areas triggered by the 50 percent – 5 percent rule.

Further, the proposal would allow, for the first time, banks to receive credit for CRA activities performed outside of a bank's delineated CRA assessment areas – in other words, any area below this 5 percent threshold or even areas from where banks do not receive deposits at all. This change will allow banks to receive credit for banking services provided in areas typically underserved, from rural towns to tribal areas. Although anything that promotes financial inclusion is to be applauded, the obvious concern is the ability of banks to pick and choose their CRA investment, i.e. in the areas that will be most lucrative for banks, untethered in any way to where the bank actually performs its business.

Unmooring – at least partially – the CRA process from the physical presence of banks or defined geographies would help to combat one of the more controversial byproducts of the CRA – banks receiving CRA credit for providing loans to middle-class individuals moving into historically low-income neighborhoods via the process of gentrification.

A new approach to assessment procedures

Banks have long complained about the CRA assessment itself, which is notoriously poorly defined, costly, time consuming, and produces results difficult to tie back to concrete examples. Under the new proposal banks would

instead be assessed on both the total number of CRA loans extended and the dollar value of these loans, rather than the current system which is believed to rely heavily on the total number of loans. Critics point out that any increased prominence of dollar-value lending will encourage banks to target more lucrative lending opportunities rather than those communities where CRA investment will provide the most benefit. The FDIC and the OCC countered this argument, however, in noting that by shifting the basis of the CRA regime from low- to middle-income *areas* to low- to middle-income *people*, the CRA will only be more targeted and effective.

The CRA test itself would also be modernized and made more transparent, with banks granted access to the actual equations used in determining their score. Further, those scores would at last be defined: “Outstanding” would indicate that CRA-compliant investments make up 10 to 15 percent of a banks retail lending within an area, and “satisfactory” would indicate such loans make up 5 to 10 percent.

Industry Reactions

The proposed reform to the CRA regime has been met with widespread support from congressional Republicans and the banking industry. Consumer Bankers Association President and CEO Richard Hunt issued the following statement: “Increasing transparency, reducing subjectivity and ensuring timely examination results are all important issues addressed in the proposal.” Senator Mike Crapo, Chairman of the Senate Committee on Banking, Housing and Urban Affairs, noted, “These proposed updates will allow covered institutions to better serve their communities.”

Congressional Democrats and consumer advocates have been less wholehearted in their support, with members of the House Financial Services Committee attending the FDIC vote on the proposal before it had even been released in protest. Although not yet published in the Federal Register, the proposal will in turn be subject to a 60 day comment period, although House Democrats have asked for a 120 day period “given the complexity of this rulemaking and the impact of the CRA, particularly within communities of color and for those who have been historically underserved by our financial system.” Senate Banking Committee Ranking Member Sherrod Brown has called on Joseph Otting, Comptroller of the Currency, to testify before the committee on the CRA proposal. David Dworkin, CEO of the National Housing Conference, noted in an interview, “[The proposal] creates a perverse incentive for investments to target the highest, largest-dollar volume, which could ultimately add to gentrification and displacement in many of these communities.

The Fed also declined to join the OCC and the FDIC in supporting this proposal. In previous efforts, the OCC has acted after receiving input from FDIC and the Fed, but reports indicate that the Fed is concerned about the new prominence of the dollar value of CRA investments in the proposed CRA assessment.

Conclusions

The FDIC and the OCC’s proposed reform of the CRA is only in draft form at the moment, as the two agencies still need to collect public feedback and respond before finalizing any reform plan. Nevertheless, it is an extremely encouraging step that real reform is proposed of a law decades out of date that does not serve communities and unnecessarily constrains banks. It remains to be seen, however, whether the agencies, following public comment, will rein back the freedom the proposal gives banks to pick and choose their CRA investments.