Harder, Better, Faster, Stronger: The New Interagency Rule for the Community Reinvestment Act

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After more than five years—with competing developments at times—the federal banking agencies (Federal Reserve, OCC, and FDIC) have revamped the regulations that implement the Community Reinvestment Act (CRA).

The final interagency rule uses a new framework to evaluate banks that features four tests with varying applicability based on a bank's total assets: a Retail Lending Test, a Retail Services and Products Test, a Community Development Financing Test, as well as a Community Development Services Test. The way the tests are formulated will require some banks to re-think their CRA plans to comply or maintain favorable ratings.

Under the rule, as Acting Comptroller Michael Hsu said, "[T]here's got to be more, it has to be better and it's got to be faster. In very simple terms, that's it: The amount of CRA investments and lending has to go up."

The rule is long and complex, with more than 60,000 words, 40 benchmarks, and 20 metrics, as FDIC Director McKernan noted in his statement voting against the final rule. Some elements still need to be finalized, such as the methodology for the Community Development Financing Test, the Retail Services Test, and the Community Development Services Test, representing collectively at least 17 benchmarks and seven metrics.

The rule principally applies to all banks and savings associations (we generally refer to them as "banks" in this alert) with potential implications for banking organizations more broadly.

Why It Matters

- It has been over 25 years since the last major update to the CRA's implementation—when interstate (physical) branching was being liberalized. Today, nationwide digital and mobile banking have dramatically changed the financial services landscape.

- According to Federal Reserve Board Governor Bowman, with respect to the Retail Lending Test and based on data from 2018 to 2020, 10 percent of banks would be rated "Needs to Improve" under the rule, compared to one percent that actually have that rating under the former rule. This change would limit their corporate activities among other potential consequences. The disparity appears to be intentional: the agencies have developed new rules to require affirmative changes at many banks.

- CRA ratings affect bank and bank holding company powers and structure options, both substantively and procedurally. For instance, under OCC rules, banks eligible for expedited treatment and after-the-fact notice for certain corporate filings must have CRA ratings of at least satisfactory, including for equity investments. In addition, a bank's CRA ratings affects whether its bank holding company can elect to be a financial holding company, or alternatively, if the bank may use a financial subsidiary to engage in expanded powers. Regulators will also consider a bank's CRA performance before approving mergers, and thus, banks out of compliance would be impeded from ordinary transactions. A poor CRA rating may affect a bank's CAMELS rating, further affecting a bank's other options as well.

- Some community banks will be subject to the rule's complex tests and requirements and will have to manage a compliance program that is far more detailed and demanding than other frameworks, for which they may otherwise enjoy regulatory relief (e.g., the community bank leverage ratio).

Key Changes/Considerations

The Tailoring is Getting Tight

- **Small banks**. Banks with less than $600 million in total assets will be subject to tests that are similar to today's framework. They will have the option to opt into the new Retail Lending Test.

- **Intermediate banks**. Banks with $600 million to $2 billion into assets will be subject to the current Community Development Test as well as the new Retail Lending Test. They can opt into the Community Development Financing Test.

- **So-called large banks**. Banks with $2 billion or more in total assets will be subject to four separate tests: the Retail Lending Test, the Retail Services and Products Test, the Community Development Financing Test, as well as the Community Development Services Test. While $2 billion is quite low compared to other thresholds ($10 billion, $50 billion, or $100 billion), the agencies want to expand CRA investments and lending and look to more banks to do so.

Flexibility for Certain Specialized Banks

Banks with specialized business models (e.g., consumer credit card banks, banks focused on auto lending) have the option to be evaluated under a strategic plan.

Equal Treatment for Large Bank's Community Development Activities and Retail Activities

The proposal would have favored the retail activities (60 percent) to community development activities (40 percent). Now each will be given an equal (50 percent) treatment.

Retail Lending Test

This test evaluates a bank's origination and purchase of home mortgage loans, multifamily loans, small business loans, and small farm loans, and may include automobile loans if the bank is a majority automobile lender.

- The Retail Lending Test uses two sets of metrics: (1) a Retail Lending Volume Screen—which measures the dollar amount of a bank's retail lending relative to its deposit base in a Facility-Based Assessment Area—compared with the Retail Lending Volume Threshold—which is based on an aggregate ratio for all reporting banks with at least one branch in the same Facility-Based Assessment Area; and (2) the geographic distribution and borrower distribution of a bank's major product lines in its Retail Lending Test Areas. A bank that does not score well under the Retail Lending Volume Screen may likely face difficulties obtaining a satisfactory rating.

- The rule adopts a more simplified Retail Lending Test as compared to the proposed rule by reducing the number of multipliers used to calculate performance thresholds. The rule also reduces the number of loan products evaluated from six to three (closed-end home mortgage loans, small business loans, and small farm loans). Automobile loans are only evaluated if they represent a majority of a bank's retail lending or if a bank opts to have its automobile lending evaluated.

Retail Services and Products Test

This test would evaluate bank branches, ATMs, as well as digital and mobile banking platforms serving low- and moderate-income (LMI) communities as well as evaluate the availability and responsiveness of bank credit and deposit products. The evaluation would only positively contribute to a bank's performance (no downgrading).

Community Development Finance Test

- This is a new test for large banks, focusing specifically on community development activities. The Community Development Financing Test considers a large bank's community development activities regardless of location, although activities within the bank's Facilities-Based Assessment Area could be weighed differently compared with its activities outside of the Facilities-Based Assessment Area. The weights applied would depend on the percentage of retail deposit-taking and lending that occurs within the Facilities-Based Assessment Area.
- The final rule also includes a metric for banks with assets greater than $10 billion to measure the bank's community development investments relative to deposits. This metric is intended to ensure a focus on certain bank community development investments (including Federal Low-Income Housing Tax Credit (LIHTC) and New Market Tax Credit (NMTC) investments).
- Under the final rule, banks will receive consideration both for new community development loans and investments and community development loans and investments that remain on a bank's balance sheet, a more accurate reflection of a bank's financing efforts.

Community Development Services Test

This test is only applicable to large banks and evaluates volunteer activities that support community development, including financial literacy activities and board service, among others.

Assessment Areas

The rule adds two new assessment areas that are based on mortgage and small business lending activities outside of areas where physical branches are located, thus assessing banks' lending to LMI communities in these areas as well. The two new assessment areas are the Retail Lending Assessment Area and Outside Retail Lending Area. The final rule also updates the Facility-Based Assessment Area, which requires large banks to delineate assessment areas that consist of full counties rather than portions of a county.

- Governor Bowman raised the concern that changes to how assessment areas are delineated may have the unintended consequence of creating a disincentive for banks to continue lending in certain areas, essentially limiting credit access.
- Large banks above $2 billion in total assets will be evaluated in the Retail Lending Assessment Area if these banks originated more than 150 closed-end home mortgage loans or 400 small business loans in each of the prior two years. However, the rule exempts large banks from the Retail Lending Assessment Area requirement if the banks conduct 80 percent or more of their retail lending activity within their Facility-Based Assessment Area, essentially tailoring this part of the rule for banks with mostly branch-based operations.
- The Outside Retail Lending Area requirement is for large and intermediate banks that conduct a majority of their retail lending outside of the physical branches.
- Banks will still be evaluated in the areas where they have physical branches, their main office, and deposit-taking ATMs (i.e., the Facility-Based Assessment Area). For large banks over $10 billion in total assets, the Retail Service Test will cover services that banks provide through digital platforms.

Compliance Period

Banks only have two years to comply, by 2026, with these extensive changes, although some bank reporting requirements will apply in 2027. Practically speaking, banks will need to begin preparing to comply immediately.

ECOA and Discriminatory Credit Practices

The rule continues to prohibit banks from delineating a Facility-Based Assessment Area that reflects illegal discrimination or arbitrarily excludes LMI census tracts. The rule also maintains the provision that CRA ratings can be downgraded because of discriminatory and other illegal credit practices, such as violations of the Equal Credit Opportunity Act, among other laws. The final rule also adds unfair, deceptive, or abusive acts or practices (UDAAP), prohibited under the Consumer Financial Protection Act, as an illegal credit practice that may result in a downgrade. However, the final rule is more narrow than the proposal, which would have required that violations of *any* applicable law could have resulted in a CRA rating downgrade.

Small Business Loans

The rule ensures that small business loans meeting specific criteria are considered for economic development in the community development tests.

Final Rule's Interaction With Other Proposed Rules

The rule does not exist in a vacuum. While the agencies want more CRA activities and lending, the proposed capital rule and bank long term debt/bail-in rule still potentially involve significant trade-offs and compliance costs. We anticipate that comments to these proposals—and particularly the proposed capital rule—will factor in the CRA requirements and changes.

List of Activities/Process to Clarify

The agencies will periodically publish an illustrative list of activities that qualify for CRA credit, and the rule has a process for banks (but not others) to request agency confirmation that a loan, investment, or service is eligible for CRA credit. The determination is limited to CRA eligibility, not legal permissibility or compliance with other laws or regulations. These determinations are expected to inform future updates to the illustrative list, but specific determinations will not be made publicly available.

Prospects of a Challenge to the Final Rule

It is possible that banks subject to the new CRA rule may decide to challenge the rule either in court, such as under the Administrative Procedures Act (APA), or by lobbying members of Congress to invalidate the rule under the Congressional Review Act. Unlike a challenge to the proposed capital rule, public perception to a CRA rule challenge, however, may not be favorable for the banks, even if various APA or Congressional Review Act hurdles can be overcome.

APA

Banks—or, more likely, the trade groups that represent affected banks—might sue to have the final rule vacated by arguing that the rule exceeds the statutory authority of the agencies or is arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law, among other arguments.

- The dissenting votes appear to have teed up some of these arguments. For instance, both Director McKernan and Governor Bowman doubt that the changes made by the final rule, including those that evaluate banks outside of their deposit-taking footprint, are within the scope of the agencies' statutory authority.
- Other challenges may include, for instance, arguments that the benchmarks and metrics are arbitrary or lack sufficient explanation or that the overall benefits of the CRA rule outweigh its complexity.

Congressional Review Act

Congress may, through a joint resolution of disapproval, overturn a federal agency rule within 60 legislative days from when it "receives" the rule. If the joint resolution is approved by Congress and is signed by the President, the rule at issue cannot go into effect. It is not clear, however, if a sufficient number in Congress can muster the opposition needed to pass such a resolution.

The Upshot

The net effect is that compliance will be a significant and costly endeavor, and some banks may have to change their existing business practices and strategies to comply with the new rule in time. If Acting Comptroller Hsu didn't consciously channel Daft Punk, their lyrics appear to summarize the new CRA framework succinctly:

> *Work it harder, make it better*
> *Do it faster, makes us stronger*
> *More than ever… [the]*
> *Work is never over.*

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