PACB
Pennsylvania Association of Community Bankers

A Renewed Focus on CRA Compliance

May 11, 2023

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Community Reinvestment Act

- Enacted in 1977 with its purpose:
  - to require each appropriate Federal financial supervisory agency to use its authority when examining financial institutions, to encourage such institutions to help meet the credit needs of the local communities in which they are chartered consistent with the safe and sound operation of such institutions (12 USC § 2901)

Effectuating the Purpose

- In connection with its examination of a financial institution, the appropriate Federal financial supervisory agency shall--
  - assess the institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of such institution; and
  - take such record into account in its evaluation of an application for a deposit facility by such institution.

Regulatory Scheme

- Purpose is actually effectuated through a complex regulatory scheme
  - CRA compliance is subject to an examination (typically every three to four years)
  - Examination considers the application of several tests – lending, investment & service
  - Examination results in a rating, which, together with the underlying evaluation, is made public

Written Evaluations and Ratings

- Public
- Ratings:
  - Outstanding
  - Satisfactory
  - Needs to Improve
  - Substantial Noncompliance
- Size of the Institution Determines Evaluation Standards
- Three tests:
  - Lending
  - Investment
  - Service

Implications of Underperformance

- While the CRA does not create a private right of action, there are practical consequences:
  - CRA performance is considered in regulatory applications
  - Regulators may limit certain operations or impose fines
  - Resolving issues is a distraction
  - Publicity results in embarrassment and reputational risk

Focus Depends (in large part) on Political Agendas

- May 2020 (Trump Admin) – OCC issues new rule "to strengthen and modernize" CRA regulations
  - Community groups sued arguing that its impact would be antithetical to CRA's purpose
- December 2021 (Biden Admin) – OCC rescinds the 2020 rule
- May 2022 (Biden Admin) – OCC, Fed and FDIC issue joint rulemaking intended to "modernize" the CRA scheme
  - Bank trade groups argue "overly complex" and potentially "arbitrary and capricious"

Implementing Regulations

- Last meaningful revision occurred in 1995
- Joint agency new rule pending – CRA Modernization (700 pages) – intended to bring CRA into the digital age
- CFPB finalized one rule on March 30, 2023 with another expected to come into play in 2024

CRA Impact on M&A

- The CRA requires bank regulatory agencies to consider a depository institution's record of helping to meet the credit needs of its local communities in evaluating applications for mergers, acquisitions, and branches.

Interagency Bank Merger Act Application

- Item 10 – Describe how the proposal will assist in meeting the convenience and needs of the community to be served
- Item 11 – Describe how the applicant and resultant institution will assist in meeting the existing or anticipated needs of its community(ies) under the applicable criteria of the Community Reinvestment Act (CRA) and its implementing regulations, including the needs of low- and moderate-income geographies and individuals

Item 11 of IBMA

- This discussion should include, but not necessarily be limited to, a description of the following:
  - The significant current and anticipated programs, products, and activities, including lending, investments, and services, as appropriate, of the applicant and the resultant institution.
  - The anticipated CRA assessment areas of the resultant institution. If the resultant institution's CRA assessment area would not include any portion of the current assessment area of the target or the applicant, describe the excluded areas.
  - The plans for administering the CRA program for the resultant institution following the transaction.
  - For an applicant or target institution that has received a CRA composite rating of “needs to improve” or “substantial noncompliance” institution-wide or, where applicable, in a state or a multistate Metropolitan Statistical Area (MSA), or has received an evaluation of less than satisfactory performance in an MSA or in the non-MSA portion of a state in which the applicant is expanding as a result of the transaction, describe the specific actions, if any, that have been taken to address the deficiencies in the institution's CRA performance record since the rating

Renewed Focus

- While Items 10 and 11 of the IBMA are not new, regulatory agencies are hyper-focused on CRA performance in evaluating bank merger applications
  - Historically, the responses to Items 10 and 11 comprised one or two pages of the application
  - Today, the responses comprise closer to 10 pages
    - Goal is to anticipate potential concerns/follow-up questions and address them in the initial filing

Recent Experience

- Bank Merger Act Application scrutinized by CRA personnel at FDIC
  - Several requests for additional information, all focused on defining the post-merger CRA assessment area
  - Major concern – "donut holes" in the assessment area suggest redlining or intentional avoidance of certain communities

CRA and Fair Lending Interplay

- CFPB 2021 Fair Lending Annual Report to Congress issued in May of 2022
  - Ensure ”fair, equitable, and nondiscriminatory access to credit…through supervision and enforcement actions, research and market monitoring activities, rulemaking and guidance, amicus activity, and consumer education”
  - Sharpening focus on digital redlining and algorithmic bias based on increasing reliance on technology
  - Continue cooperation with other regulators and law enforcement agencies to ensure fair lending and equal credit opportunity
    - Enforcement of fair lending laws is priority for DOJ

CRA and Fair Lending Interplay

- Focus on "Modern-Day Redlining"
  - Geographic Scope
    - Geographic area in which lender's performance is measured is a threshold issue for redlining review
    - Compares institution's provision of credit in racially different areas
    - Compliance teams should carefully review accuracy of any formal or informal documentation that describes a "footprint" or "market area"
  - Minority Communities
    - DOJ and CFPB have defined redlined "minority" communities as those where 50% or more of the population "identified as Black, Hispanic, Asian, Native American, Native Hawaiian, or Pacific Islander in the U.S. Census"
    - To accurately evaluate redlining risk, institutions must be aware of the unique demographic makeup in areas in which they do business and tailor their analyses appropriately

CRA and Fair Lending Interplay

– Peer Lenders
  - Redlining evaluations typically involve comparing lender's relative performance in serving minority communities to other lenders
  - If third party analysis is done, compliance officers should review peer groups in those reviews and properly elevate any noted issues to management and develop an action plan for minority market penetration

– Physical Locations and Loan Officers
  - Must consider physical location of offices and loan officers, as well as racial makeup of sales force and ability to generate business in all communities in which lender operates

CRA and Fair Lending Interplay

– Email Content
  - Must be aware that investigations of illegal discrimination are more likely to involve reviews of electronically stored email communications
  - Regular training of employees on fair lending compliance and company policies on email usage is critical

– Marketing to Minority Populations
  - Must ensure that materials do not indicate impermissible preference and should be designed to reach all segments of community

Consumer Examination – Redlining Concerns

- Review your policies and how you define your trade/market area versus your CRA assessment area (AA)
  - Trade/Market Area: "All counties in which the bank maintains a branch and all contiguous counties."
  - CRA AA: omits Philadelphia County
- Philadelphia County is contiguous to Bucks, Delaware and Montgomery Counties

Prompts Regulatory Scrutiny

- Is Philadelphia County considered part of the bank's trade/market area? If not, why not?
- Describe all marketing and outreach efforts made in Philadelphia County during the subject time period.
- Describe all targeted marketing and outreach efforts made by the bank in majority black tracts in Philadelphia County during the subject time period.

Consistency is Key

- It is imperative that the marketing/business development activities that the bank implements are consistent across the entire trade/market area

Redlining Concerns Impact Strategic Initiatives

- Must be resolved prior to execution of a definitive agreement for a strategic combination
  - Representations/warranties must be true and correct at time of signing and closing, and always address pending or threatened regulatory issues
  - Presence of CRA issues, like BSA issues, creates deal uncertainty and closing risk

CRA Modernization Overview

- Joint Notice of Proposed Rulemaking (NPR) issued May 5, 2022
- Comment Period Expired August 5, 2022
- Proposed Effective Date of Final Rule – 60 days after publication in Federal Register
- 12-month implementation period

Stated Objectives of Joint NPR

- Strengthen achievement of core purpose of CRA
- Adapt to changes (mobile/online banking)
- Increase clarity and consistency
- Tailor standards to account for bank size, business model and local conditions
- Tailor data collection and reporting requirements
- Promote transparency/public engagement
- Confirm that CRA and fair lending responsibilities are mutually reinforcing

Evaluation Frameworks

- Vary depending on bank size/type
  - Large Banks = Assets > $2B
  - Intermediate Banks = Assets > $600MM and < $2B
  - Small Banks = Assets < $600MM
  - Wholesale and Limited Purpose Banks

Assessment Areas (AAs)

- Facility-Based AAs (tailored by bank size)
  - Where banks have their main offices, branches and deposit-taking remote service facilities
- Retail Lending AAs (only large banks)
  - Where banks have concentrations of home mortgage or small business lending outside of its facility-based AAs
- Outside Retail Lending Areas (large banks and to intermediate banks with substantial outside AA lending)
  - Retail loans located outside of any facility-based AA or retail lending AA
- Areas for Eligible Community Development Activity (large, wholesale and limited purpose, and intermediate banks that elect)
  - Areas outside of facility-based AAs where bank engages in community development activities

Performance Tests (Types)

- Retail Lending Test
  - Measures bank's retail lending relative to its capacity to lend in a particular facility-based AA
  - Geographic and borrower distribution metrics used
- Retail Services and Products Test
  - Measures bank's delivery systems and deposit and other products through the use of certain metrics and performance context
- Community Development (CD) Financing Test
  - Use a CD metric paired with an impact review to evaluate quantitative and qualitative aspects of a bank's CD financing activity
- Community Development Services Test
  - Measures responsiveness to community needs (mostly qualitative, but does use some metrics)

Performance Tests (Application)

- Large banks evaluated under all 4 proposed performance tests
- Intermediate banks evaluated under Retail Lending Test and current community development test or, at bank's option, proposed CD Financing Test
- Small banks evaluated under current small bank lending test or, at bank's option, proposed Retail Lending Test
- Wholesale and limited purpose banks evaluated under modified CD Financing Test
- Banks of all sizes retain option to request approval to be evaluated under an approved strategic plan

CD Activities

- Eligibility of CD Activities expanded in certain areas, including for mission-based entities and Native Land Areas
- To provide additional certainty as to what CD activities qualify for CRA credit, NPR proposes that agencies maintain a non-exhaustive list of qualifying activities eligible for CRA consideration and a process for agencies to update list periodically
- To promote clearer and more consistent evaluation procedures, NPR includes “impact review factors” to inform evaluation of the impact and responsiveness of a bank’s CD activities

Data Collection and Reporting

- Large banks with assets over $10 billion required to collect, maintain and report data for retail deposits, retail lending, retail services, CD loans and investments, CD services, and AAs
- Large banks with assets between $2-$10 billion subject to some data collection and reporting requirements
- Intermediate and small banks would collect data in normal course of business as they do currently

Performance Score and Ratings

- Performance Score – conclusions for a bank for each applicable performance test at each applicable AA level, as well as state, multistate and institution level
  - Outstanding
  - High Satisfactory
  - Low Satisfactory
  - Needs to Improve
  - Substantial Noncompliance
- Ratings – single score based on combining conclusions to rate bank's overall rating
  - Outstanding
  - Satisfactory
  - Needs to Improve
  - Substantial Noncompliance

Recommendations

- Somewhat limited in what can do before rules are final, but important to get a plan in place
  - Get familiar with proposed changes
  - Be proactive in outlining how your bank can achieve compliance
  - Raise awareness about changes to CRA within your organization
    - Educate BOD and senior leadership teams about basic proposed requirements, impact, and plan to address that impact
  - Identify facility-based AAs and potential retail lending AAs
  - Involve technology executives early on in the process (not just compliance and risk management)
  - Consider costs of hiring or increased training of staff
  - Examine redlining risk through data analysis and reviewing compliance/risk management policies and procedures - this legislation will only continue to intensify regulatory scrutiny and emphasis on fair lending and CRA compliance and the interplay between them

CFPB's New Rule – Small Business Lending

- Effective March 30, 2023
- Requires small business lenders to collect detailed demographic and financial data about applications and originations, and report that information annually

Small Business Lending Rule - Purposes

- To facilitate enforcement of fair lending laws and enabling the identification of business and community development needs and opportunities for women-owned, minority-owned and small businesses.

Small Business Lending Rule - Coverage

- “Covered Financial Institutions”
  - Determined annually
  - Any entity that originated at least 100 covered credit transactions in the past two years
    - Defined as Reg B extensions of business credit (e.g., loans, lines of credit, credit cards) to small businesses ($5MM or less in gross annual revenue for its preceding fiscal year)
    - Certain categories of Reg B loans are excluded
    - Loans to nonprofits are not included

Small Business Lending Rule – Reportable Applications

- Covered banks must collect and report data points and other information regarding applicants and covered applications
  - Covered application is a written or oral request for a business credit transaction covered by the rule (similar to Reg B's definition of "application")
  - Data points include credit type, purpose, amount, census tract of applicant, revenue of applicant, minority/women/LGBTQI+ -owned status and principal owners' ethnicity/race/sex

Small Business Lending Rule - Phase-In

- Three-year phase-in
- Lenders originating:
  - 2,500 loans must commence data collection October 1, 2024;
  - 500 loans starting April 1, 2025; and
  - 100 loans starting January 1, 2026

Questions?

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