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Crossing a New CRA Asset Size Threshold? What Your Bank Needs to Know.

By Mickey Marshall

Introduction

Since the beginning of the coronavirus pandemic, the total assets of all U.S. commercial banks have grown by more than $5 trillion—that's trillion with a "T."[1] This unprecedented balance sheet expansion, as well as the continued trend of consolidation in the industry, has pushed some community banks into a new Community Reinvestment Act (CRA) asset-size categorization sooner than anticipated.

This issue brief will discuss:

- The increased regulatory expectations associated with moving up from being a small bank to an intermediate small bank (ISB) or from an ISB to a large bank.
- Strategies community banks can use to successfully manage these growing pains and demonstrate compliance.

Background

The CRA was enacted in 1977 to combat redlining and requires banks to meet the credit needs of the communities they serve. Regulators determine compliance by evaluating banks' lending and investment in low- and moderate-income (LMI) census tracts and the proportion of their lending to LMI families, small businesses, and small farms. As banks increase in asset size, they are subject to more detailed CRA performance evaluations.

All three prudential regulators responsible for conducting CRA exams (the Office of the Comptroller of the Currency, Federal Deposit Insurance Corp., and Federal Reserve Board) use the same three asset-size categories. Banks under $346 million are evaluated as small banks; banks with assets from $346 million to $1.384 billion are evaluated as ISBs; and banks with more than $1.384 billion in assets are considered large banks.

Small banks are evaluated using only the Lending Test, which evaluates a bank's lending activities by considering its home mortgage, small business, small farm, and community development lending. If consumer lending makes up a substantial majority of a bank's lending portfolio, it will be evaluated as well.

ISBs are subject to the Lending Test, conducted in the same manner as it is for small banks, but they are also subject to the Community Development Test, which evaluates a bank's record of making qualified community development loans, investments, and services.

[1] Federal Reserve Bank of St. Louis, Federal Reserve Economic Data (FRED), "Total Assets, All Commercial Banks," available at: https://fred.stlouisfed.org/series/TLAACBW027SBOG/.

Finally, large banks are subject to the Lending Test, the Investment Test, and the Service Test. The Investment Test evaluates the amount and responsiveness of a bank's community development investments. The Service Test evaluates both the availability and effectiveness of a bank's systems for delivering retail banking services and the extent and innovativeness of its community development services.

CRA Modernization

The regulatory agencies are in the process of modernizing CRA's implementing regulations, with the OCC reversing course on a new CRA framework it finalized in June 2020. That rule attempted to make performance evaluations strictly quantitative and to significantly change the definitions of qualifying activities. As advocated by ICBA, the rule also raised the small bank asset threshold to $600 million and the ISB threshold to $2.5 billion.

While the OCC's 2020 rule made several positive changes, it also imposed additional data collection burdens on community banks and did not include the FDIC or Federal Reserve Board, leading to a confusing and unequal regulatory landscape. Because of this, ICBA advocated for the rescission of the 2020 rule and urged the OCC to engage in a joint rulemaking with the FDIC and Fed.

On Dec. 14, 2021, the OCC rescinded the 2020 rule, returning to its 1995 rule, which the FDIC and Fed also use. ICBA supports this decision and believes it will lay the groundwork for interagency cooperation. However, it also means that the increased asset thresholds of $600 million and $2.5 billion have been reverted to **$346 million for small banks** and **$1.384 billion for ISBs** used by the other regulators in 2021. ICBA will advocate for the agencies to raise these thresholds in the forthcoming interagency rulemaking.

While these changes have been difficult to keep up with, overhauling a complicated regulation like CRA is bound to be a bumpy process. In the coming year, ICBA will work to ensure the agencies reach an agreement on a proposed rule that better assesses branchless internet banks, minimizes the data collection and compliance burden for community banks, and, most importantly, ensures the financial needs of LMI families and communities are being met.

In the meantime, banks must maintain compliance with the current rule. Therefore, with the caveat that the asset thresholds and requirements described below are subject to change, the following sections recap the requirements of the Lending Test and walk through the requirements of the Community Development Test, the Investment Test, and the Service Test for banks that are or will be subject to them for the first time.

Small Bank Lending Test

The Lending Test is the baseline test that applies to all banks and all of their assessment areas. It "evaluates a bank's record of helping to meet the credit needs of its assessment area(s) through its lending activities by considering a bank's home mortgage, small business, small farm, and community development lending."[2] In some cases, the test will also include an evaluation of consumer lending.

The Lending Test examines a bank's lending activity and analyzes the geographic distribution of loans and the characteristics of bank borrowers. Banks will be rewarded on the Lending Test for making a higher percentage of loans inside their assessment area(s), making an appropriate percentage of loans in LMI census tracts, and making an appropriate percentage of loans to LMI individuals, small businesses (under $1 million in annual revenue), and small farms.

Examiners will determine the appropriate level of lending to LMI individuals and small businesses by evaluating a bank's financial capacity and by analyzing the demographics of the assessment area and the lending patterns of peer lenders. Bankers can and should use data to measure their performance against similarly situated banks and the market.

In addition to the Lending Test, all banks will be evaluated on their fair lending exam performance and their responsiveness to customer complaints. Violations of fair lending laws can dramatically affect CRA ratings, so banks need to ensure their fair lending compliance program appropriately mitigates the risk of inadvertent violations. According to CFPB data, between 81 and 271 financial institutions per year have been cited for violating the Equal Credit Opportunity Act between 2014 and 2020.[3] No evidence of discriminatory intent is required to prove a violation of fair lending laws—a disparity of outcomes evident in the lending data is sufficient to prove a disparate impact claim.

Intermediate Small Bank Evaluation

When banks become ISBs, they become subject to the CRA's Community Development Test. This test evaluates the number and amount of community development loans, investments, and services. To qualify, loans, investments, or services must provide one of the following as their primary purpose:

1) Affordable housing.
2) Community services targeted to low- and moderate-income individuals.
3) Activities that promote economic development.
4) Activities that revitalize or stabilize LMI geographies.

With the exception of affordable housing, community development loans cannot count for credit on both the Lending and Community Development Tests. Banks must choose to count them on one test or the other.

Some examples from recent performance evaluations of loans and investments that have received credit as community development are:

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[2] 12 CFR 228.22(a)

[3] Bureau of Consumer Financial Protection, "Fair Lending Report of the Bureau of Consumer Financial Protection" (April 2021), available at: [Recommendation and Decision memo Fair Lending Annual Report final 4.8.21 signed.pdf (consumerfinance.gov)](consumerfinance.gov).

- A loan to finance the construction of a nursing care facility that offers 120 dually certified Medicaid-Medicare beds, with the expectation that Medicaid recipients will occupy 65 percent of the beds. *Credit received under prong (2) community services.*
- A construction loan for a 33-unit senior housing project in which all units are income-restricted to 60 percent of area median income or below and 12 of the units are set aside specifically for Section 8 housing. *Credit received under prong (1) affordable housing.*
- A loan to provide financing for a major redevelopment project. The project offers over 81,000 square feet of retail, office, and restaurant space that created many permanent low- and moderate-income jobs in the area. *Credit under prong (3) economic development.*
- Direct investments in minority depository institutions (MDIs) or low-income credit unions. *Credit under prong (4) revitalize/stabilize.*
- A loan to a community development financial institution (CDFI). The CDFI's mission is to strengthen communities, build assets, and improve lives in economically distressed areas by providing access to high-quality financial products and services. *Credit under prong (4) revitalize/stabilize.*
- Disaster relief grants to help revitalize and stabilize communities affected by the earthquake in Puerto Rico and California wildfires and to support various COVID-19 relief programs. *Credit under prong (4) revitalize/stabilize.*

Activities will always receive credit under the Community Development Test if they provide a direct benefit to a bank's assessment area(s) or if they go to an organization that has the purpose, mandate, or function to serve the bank's assessment area(s). Qualifying activities that do not serve and will not benefit the bank's assessment area(s) *may* receive credit *if* the bank has already been responsive to the needs and opportunities in its assessment area(s).

Large Bank Evaluation

Large banks are subject to the most intensive CRA evaluation, which includes the Lending Test, the Investment Test, and the Service Test. The Investment Test "evaluates a bank's record of helping to meet the credit needs of its assessment area(s) through qualified investments that benefit its assessment area(s) or a broader statewide or regional area that includes the bank's assessment area(s)."[4] The Service Test analyzes "the availability and effectiveness of a bank's systems for delivering retail banking services and the extent and innovativeness of its community development services."[5]

Large banks are evaluated for each test on a five-tier system: Outstanding, High Satisfactory, Low Satisfactory, Needs to Improve, and Substantial Non-Compliance. The Lending Test is weighted more heavily when establishing the bank's overall CRA rating.

The performance criteria for the Investment Test are:

1) The dollar amount of qualified investments.
2) The innovativeness or complexity of qualified investments.

[4] 12 CFR 228.23(a).
[5] 12 CFR 228.24(a).

3) The responsiveness of qualified investments to credit and community development needs.
4) The degree to which the qualified investments are not routinely provided by private investors.[6]

Qualified investments under the investment test are community development investments that would qualify for credit under the community development test for ISBs. Importantly, the responsiveness of these investments and the degree to which they are not routinely provided by private investors are components of the evaluation. In other words, the investment test is not purely an evaluation of the dollar value of qualifying investments; it also considers their impact. This can be an advantage for larger community banks, which may have a deeper local knowledge than their megabank peers.

Additionally, grants and donations to qualifying organizations are awarded credit under the investment test. Because the investment test considers the impact of qualifying activities, banks that offer grants or investments should be prepared to demonstrate that these charitable activities are responsive to local needs. While loans to or investments in community development organizations can be impactful, grants could have an even bigger community impact because they do not need to be repaid.

Investments in MDIs and CDFIs are often eligible for CRA credit under the Investment Test and can help banks provide access to credit to LMI individuals.

Under the Service Test, banks are evaluated on the extent to which they make retail banking services available to LMI customers using the following performance criteria:

1) The current distribution of the bank's branches among low-, moderate-, middle-, and upper-income geographies.
2) In the context of its distribution of branches, the bank's record of opening and closing branches, particularly branches located in LMI geographies or primarily serving LMI individuals.
3) The availability and effectiveness of alternative systems for delivering retail banking services in LMI geographies and to LMI individuals (e.g., ATMs, ATMs not owned or operated by or exclusively for the bank, banking by telephone or computer, loan production offices, and bank-at-work or bank-by-mail programs).
4) The range of services provided in low-, moderate-, middle-, and upper-income geographies and the degree to which the services are tailored to meet the needs of those geographies.[7]

Under the Service Test, the community development services banks offer are evaluated using the following criteria:

1) The extent to which the bank provides community development services.
2) The innovativeness and responsiveness of community development services.[8]

The Service Test adds a new element for banks by making their branch presence in LMI areas an important component of CRA exams. Banks should be sure to consider the implications of opening and closing branches in LMI census tracts on their CRA performance. Banks should also plan to offer

[6] 12 CFR 228.23(e).
[7] 12 CFR 228.24(d).
[8] 12 CFR 228.24(e).

alternative delivery systems like ATMs and online banking that are responsive to the needs of LMI individuals in their assessment area(s).

Looking for Credit? Consider CRA Partners, a Wholly Owned Subsidiary of ICBA.

Banks seeking qualifying activities for the community development test or the large bank investment test can schedule a consultation with CRA Partners, a wholly owned subsidiary of ICBA. Partnering with CRA Partners supports the Senior Housing Crime Prevention (SHCP) Foundation, which provides free financial education to low-income seniors in bank assessment areas and works to prevent elder financial abuse.

Under the program, banks make a CRA-qualified community development loan, investment, or grant to the SHCP Foundation to support the Senior Crimestoppers program in senior housing facilities, HUD communities, and state veterans' homes in the bank's assessment area. All loans and investments are fully collateralized by CRA-qualified securities selected by participating banks.

Banks may earn credit in three ways:

1) For the principal of their financial commitment, either as a community development loan or as a qualified investment.
2) On interest retained by the SHCP Foundation each year as a grant under the investment test.
3) Grants to the SHCP Foundation that can be counted under the investment test.

The CRA Partners program has been recognized as a qualifying activity by the FDIC, Federal Reserve Board, and OCC. For more information about how to earn CRA credit by supporting CRA Partners' mission to prevent elder financial abuse, email info@shcpfoundation.org or call 877-232-0859.

Additional Resources

ICBA's CRA positions, letters to policymakers, and more are available on its CRA webpage. Community bankers with specific comments or questions about CRA modernization can contact me at Michael.Marshall@icba.org.

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