CENTER FORWARD

The Community Reinvestment Act

Center Forward Basics

August 2024

Overview

The Community Reinvestment Act (CRA), enacted in 1977, is a landmark piece of legislation to ensure banks and financial institutions serve the credit needs of all communities, including low and moderate-income (LMI) neighborhoods. The CRA mandates the Federal Reserve and other regulatory bodies evaluate the community service records of banks, which are published and considered when approving acquisitions, bank mergers, charters, and branch openings. In 2023, the CRA Final Rule was issued to update existing regulations, in an attempt to reflect modern developments within the banking industry, such as the emergence of mobile and online banking. The new requirements were set to take effect in two phases: most provisions would have taken effect on January 1, 2026, with the remaining provisions taking effect on January 1, 2027, however a federal judge in Texas has issued a preliminary injunction pending further litigation, almost certainly pushing back this implementation deadline. This Basic will provide an overview of the key components of CRA regulations and explain the significant changes introduced by the final rule, including new Retail Lending Assessment Areas, adjustments in bank size categorizations, and updated evaluation tests.

The Origins of the CRA

The CRA was enacted to combat the discriminatory practice of redlining, which involved banks delineating certain neighborhoods as too risky for the provision of financial services. The practice was visually represented by red lines drawn on maps to outline these high-risk areas, coining the term "redlining." Consequently, residents in these communities, which typically had large minority populations and lower incomes, were systematically denied access to essential financial services. The practice substantially exacerbated economic inequalities within LMI neighborhoods.

To address this issue, the CRA requires banks and other financial institutions to help meet the credit needs within their local areas, within safe and sound banking practices determined by where the bank operates and takes deposits. The Federal Reserve Board (FRB), the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC) are responsible for evaluating a bank's compliance with the CRA through a series of assessments of its lending, investment and service activities. To receive CRA credit, banks must engage in activities that benefit LMI communities. Examples of these include investments in affordable housing, educational programs for LMI families, and economic development initiatives such as small business financing.

Banks' CRA responsibilities vary by asset size, categorized into small, intermediate, and large institutions. Following evaluations, banks receive performance ratings ranging from "Outstanding" to "Substantial Noncompliance." To earn an "Outstanding" rating, a bank must demonstrate exceptional responsiveness to the credit needs of its local areas. This includes providing loans in its branch footprint, ensuring a balanced loan distribution across income levels and business

Center Forward Basics

Center Forward brings together members of Congress, not-for profits, academic experts, trade associations, corporations and unions to find common ground. Our mission: to give centrist allies the information they need to craft common sense solutions, and provide those allies the support they need to turn those ideas into results.

In order to meet our challenges we need to put aside the partisan bickering that has gridlocked Washington and come together to find common sense solutions.

For more information, please visit www.center-forward.org

sizes in line with the makeup of the community and market opportunity, and making significant investments in LMI areas. In developing their evaluations, bank regulators seek the opinions of community leaders regarding a bank's commitment to the community. A key component of the CRA mandates federal agencies consider a bank's CRA rating when the bank applies for acquisitions, mergers, charters, and branch openings. Banks that fail to adequately serve LMI communities may face delays or denials in their applications. The evaluations are also made publicly available to promote transparency and accountability.

The Final Rule

Since its inception, the CRA has undergone several statutory amendments and regulatory updates to strengthen and modernize existing regulations. The most recent of these amendments, the CRA final rule, was issued on October 24, 2023, and is set to substantially impact how banks' compliance with the CRA is evaluated. The final rule introduces updated evaluation methods, incorporating new metrics considering bank size, bank type, and community service measures in an attempt to better align with modern banking practices.

Under the final rule, requirements continue to vary based on banks' size and business model; however, adjustments are made to reflect changes in the banking industry and inflation. Small banks are now defined as those holding assets worth less than $600 million, intermediate banks hold less than $2 billion, and large banks hold over $2 billion. Small banks can continue to be evaluated as per the existing CRA framework or opt into the new framework. Intermediate and large banks are mandated to follow the new framework, which notably includes more robust requirements for data reporting, data collection, and maintenance.

Notably, the final rule expands the evaluation of banks' lending activities to address the growing prevalence of online and mobile banking, branchless banking, and hybrid models. It allows regulators to assess loans generated through outside a bank's physical branch locations by defining new Retail Lending Assessment Areas (RLAAs), designated based on where banks conduct a significant level of retail lending, irrespective of their physical presence. Additionally, the new rule considers the community development activities carried out by banks nationwide. The new rule also emphasizes activities in traditionally underserved areas, such as rural and Native American communities.

Evaluation Framework Under the Final Rule

The final rule introduces a new metrics-based approach to assessing banks' retail lending and community development financing practices. It aims to establish standardized performance benchmarks derived from peer and demographic data to facilitate a more straightforward comparison and evaluation of banks' CRA performance. However, performance benchmark data is not available to banks until after the performance period.

Under this updated framework, banks will be evaluated based on their engagement within LMI communities. Specifically, large banks will be subject to four distinct tests with varying weights:

- **Retail Lending Test (weighted 40%):** Evaluates a bank's efforts to meet the credit needs of LMI individuals and small loans to businesses and farms. It examines the number and dollar value of loans (mortgages, small business lending, and potentially introduces auto lending)banks provide within their local communities and evaluates how these are distributed across different income levels and business sizes.
- **Retail Services and Products Test (weighted 10%):** Measures the accessibility of retail banking services provided by banks and their responsiveness to the credit needs of the community. It evaluates the distribution of banks' physical branches and ATMs, particularly in LMI areas, and assesses the availability of their digital product offerings.
- **Community Development Financing Test (weighted 40%):** This test evaluates the extent of banks' community development financing activities, including investments in multifamily affordable housing, community facilities, infrastructure improvements, and economic development loans. It measures the total value of banks' community development loans and investments and evaluates the impact and responsiveness of their activities to the needs of their communities.

- **Community Development Services Test (weighted 10%):** Reviews the efforts of banks to build capacity and foster effective community development (e.g., board service, volunteerism in support of LMI communities). It measures the innovativeness and responsiveness of banks' community development services.

While these tests collectively aim to provide a more comprehensive evaluation of banks' activities related to community reinvestment to meet the evolving needs of LMI communities, some have concerns that changes may have unintended consequences.

Concerns & Challenges

The current CRA rule is under a level of scrutiny due to several pressing challenges and concerns. In current litigation, filed by a group of national, state, and local associations against the rule, the groups argue the complexity of the rule and its weighting would incentivize closing branches and reduction of product offerings, a contradiction of the stated purpose of the CRA to ensure credit access for underserved communities. For example, the complaint argues that the regulatory agencies exceeded their authority by evaluating bank lending outside of branch footprint and deposit-products rather than credit needs. The new rule devalues small business lending, reduces the importance of branch/ATM distribution, and introduces Auto lending which has not been a primary credit need expressed by communities. Additional concerns about the effectiveness of the CRA in addressing modern financial services' complexity, given its framework was established decades ago have been brought up. With the evolving landscape of digital banking and fintech companies, challenges arise in assessing and regulating their contributions to community reinvestment. Balancing regulatory requirements with the need for robust community support remains a contentious issue. Given limited capacity, both in human and deployable capital, a greater emphasis on areas outside a financial institution's community may lead to fewer resources within the company's local community where physical locations and employees are a core of their business. As the financial landscape continues to evolve, it is crucial to ensure the CRA effectively addresses the complexities of modern banking while fostering fair access to credit for all communities, given the difficulties of assessing impact on communities of so many changes at once.

Preparing for Regulatory Changes

While originally scheduled to be implemented in 2026 and 2027, ongoing litigation is creating uncertainty of the future of those dates and the rule itself. To effectively navigate these new regulations, however, institutions may proactively enhance their data reporting capabilities, refine their community engagement strategies, and ensure the alignment of their operations with the updated evaluation metrics. Key steps include investing in advanced data systems to capture a wider range of lending, investment, and service activities, which are crucial for demonstrating compliance under the new framework. Additionally, institutions could leverage digital and branchless banking models to broaden access to financial services and adapt community development initiatives to the evolving needs of LMI areas. The CRA remains a crucial piece of legislation aimed at improving the provision of financial services within LMI neighborhoods and significantly impacts banks' operations within their local areas. As the Act undergoes important updates and modernization through the final rule, banks must be prepared to implement changes to align with the new regulatory framework and continue to serve their local communities effectively.

Links to Other Resources

- Anders CPAs + Advisors - CRA Modernization Final Rule: What Banks Need To Know To Prepare
- FDIC - Interagency Overview of the Community Reinvestment Act Final Rule
- Grant Thornton - Community Reinvestment Act: Interagency final rule requirements combine art with science
- NY FED - The Community Reinvestment Act Decoded
- OCC - Community Reinvestment Act (CRA)