Community Reinvestment Act Overhaul & Key Small Business Lending Issues

New York Bankers Association

Retail & Small Business + Trust & Investment Conference

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Agenda

- Federal regulators' joint CRA rulemaking
- DFS CRA rulemaking to implement minority- and women-owned businesses legislation
- CFPB's Dodd-Frank Section 1071 small business lending data collection and reporting rulemaking
- Risks and challenges for banks
- Projected implementation timeline and how these rule proposals are interrelated

Summary of Recent CRA Rulemaking

OCC-FDIC NPR and OCC Final Rule

- On December 12, 2019, the FDIC and the OCC issued a joint NPR to revise and update their CRA regulations. The Federal Reserve did not join in issuing this NPR.
- The OCC issued a new CRA final rule on May 20, 2020. Neither the FDIC nor the Federal Reserve joined the OCC, meaning that national banks and state-chartered banks would be subject to a different CRA regulatory framework.

Federal Reserve ANPR

- On September 21, 2020, the Federal Reserve issued its own CRA ANPR.

DFS

- On November 3, 2021, DFS issued a proposed rule to implement an amendment to the New York CRA that requires DFS to evaluate the extent to which banks offer and provide credit to minority- and women-owned businesses.

Recent Developments

- On July 20, 2021, the federal agencies issued an interagency statement indicating they would work collectively to develop a new, consistent CRA regulatory framework.
- The OCC indicated on the same day that it would rescind its 2020 final rule, and formally rescinded that rule and replaced it with OCC's prior regulations on December 15, 2021.
- On May 5, 2022, the OCC, Federal Reserve, and FDIC issued a joint NPR intended to modernize the agencies' CRA rules.
- The comment period for the NPR closed on August 5, 2022.

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Joint Federal CRA Rulemaking

FDIC Chairman Gruenberg's "Top Ten List"

June 13 Remarks at National Community Reinvestment Coalition Conference

1. Expanding the Scope of CRA – New Retail Lending Assessment Areas
2. Raising the Bar for Retail Lending Performance—New Metrics and Standards For Particular Ratings Would Be Higher Than Past Experience
3. Greater Clarity, Consistency, and Transparency for CRA Evaluation
4. Tailoring CRA Requirements to Bank Size, Complexity, and Business Type
5. Enhanced Transparency for Lending to Communities of Color through Use of Publicly Available HMDA Data
6. Expanding Consideration of Scope of Illegal and Discriminatory Conduct to Include Deposit or Other Bank Activities
7. Provisions Related to MDIs and CDFIs
8. Addressing Credit or Banking Deserts, Including Rural Areas, Native Lands, and Areas of Persistent Poverty
9. Encouraging the Retention or Establishment of Branches in LMI Communities and Low-Cost Transaction Accounts
10. Strengthening Disaster and Climate Resilience in LMI Communities

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New Definitions of Assessment Areas

- **Facility-based assessment areas (§ __.16)**
  - Banks would continue to delineate what would now be called “facility-based assessment areas” where they have their main offices, branches, and other staffed or remote deposit-taking facilities that are open to the general public. § __.16(b).
  - Banks would be evaluated under each of the applicable Performance Tests in facility-based assessment areas.
- **Retail lending assessment areas (§ __.17)**
  - Large banks would be required, for the first time, to establish “retail lending assessment areas” where they have concentrations of at least 100 home mortgage loans or at least 250 small business loans outside of their facility-based assessment areas in two consecutive years. § __.17(c).
  - These new assessment areas would consist of either (1) the entirety of a single metropolitan statistical area (MSA), excluding areas already within a bank’s facility-based assessment area, or (2) all of the nonmetropolitan counties in a single state, excluding counties inside their facility-based assessment areas, aggregated into a single retail lending assessment area. § __.17(b).
  - Banks would be evaluated under the Retail Lending Test in these new assessment areas, but not other performance tests (i.e., Retail Services Test or Community Development tests).

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Performance Tests and Standards

Performance Tests and Standards – Large Banks

Assets of at least $2 billion in the prior two calendar years.

- Retail Lending Test
- Retail Services and Products Test
- Community Development Financing Test
- Community Development Services Test

Additional requirements if assets of at least $10 billion in the prior two calendar years.

- Evaluation of digital and other delivery systems and deposit products.
- Evaluation of deposit products responsive to the needs of low- or moderate-income individuals.
- Metric to measure the hours of community development services activity per full time employee of a bank.
- New data requirements for deposits, automobile lending, retail services on digital delivery systems, retail services on responsive deposit products, and community development services.

Performance Tests and Standards – Intermediate, Small, and Wholesale Banks

- **Intermediate banks**
  - A substitute for the current "intermediate small" category.
  - Average quarterly assets, computed annually, of <u>at least $600 million</u> in the prior two calendar years <u>and less than $2 billion</u> in either of the prior two calendar years.
  - Retail Lending Test and the *status quo* community development test, with choice to opt into new Community Development Financing Test. § __.21(b)(2).
- **Small banks**
  - Average quarterly assets, computed annually, of <u>less than $600 million</u> in either of the prior two calendar years.
  - *Status quo* small bank lending test, with choice to opt into new Retail Lending Test. §§ __.21(b)(3), .29(a).
- **Wholesale banks**
  - Tailored version of the Community Development Financing Test.

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Retail Lending Test

Application by bank size

- Large banks would be evaluated under this test in facility-based assessment areas, retail lending assessment areas, and at the institution level outside retail lending areas. § __.22(a)(2).
- Intermediate banks would be evaluated under the test in facility-based assessment areas, and also outside its facility-based assessment areas if the bank originates and purchases over 50 percent of its retail loans, by dollar amount, outside of its facility-based assessment areas. § __.22(a)(3).
- Small banks would be evaluated under the current lending test, unless they opt into the new Retail Lending Test. § __.21(b)(3).

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Retail Lending Test

Products evaluated

- The following retail lending product line categories would be evaluated: closed-end home mortgage, open-end home mortgage, multifamily, small business, small farm lending, and auto lending. § __.22(a)(4)(i).
- Significant changes from existing lending test:
  - All small business and small farm lending would be evaluated under the new Retail Lending Test.
  - Auto lending would be included for the first time in CRA evaluations.
- "Small business" and "small farm" would be defined consistent with the CFPB's proposed small business lending data collection rule under Dodd-Frank Section 1071.
- These products would be evaluated when they qualify as a "major product line"—generally, when a product comprises 15% or more of a bank's retail lending volume in an assessment area. § __.22(a)(4)(ii), (iii).

Retail Lending Test

Metrics (Appendix A of the NPR)

- Retail lending volume screen: would assess a bank's volume of retail lending relative to its deposit base, compared to other banks in each facility-based assessment area. (Appendix A, Section I.)
- Distribution metrics and thresholds: would individually evaluate each of a bank's major product lines, in each facility-based assessment area, retail lending assessment area, and outside retail lending area. (Appendix A, Sections II, III, IV.)
  - Separate evaluation of geographic distribution and borrower distribution for each product line.
  - Metrics would distinguish between different income levels and business and farm sizes (e.g., LMI tracts, LMI borrowers, sizes of small businesses and farms).
  - Thresholds would differ across assessment areas based on local data.
- Scores would be assigned by product line and aggregated to determine the bank's rating.

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Retail Services and Products Test

- Applicable to large banks.
- This test would remain predominantly qualitative, with certain quantitative measures incorporated.
- Would evaluate delivery systems, including branching, remote service facilities, and digital delivery systems. § __.23(b).
    - Evaluation of digital delivery systems would be required only for large banks with assets of over $10 billion; large banks less than $10 billion could request additional consideration.
- The credit and deposit products components of the proposed test would evaluate a bank's efforts to offer products that are responsive to the needs of low-and moderate-income communities. § __.23(c).
    - Evaluation of deposit products responsive to the needs of LMI individuals would be required only for large banks with assets of over $10 billion; large banks less than $10 billion could request additional consideration.

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Community Development Financing Test

- Would apply to large banks as well as intermediate banks that choose to opt into this test.
- Assessed at the facility-based assessment area, state, multistate MSA, and institution levels—but <u>not</u> in retail lending assessment areas.
- Would consist of a community development financing metric, benchmarks, and an impact review. (§ __.24 and Appendix B of the NPR.)
  - Financing metrics would measure the dollar value of a bank's community development loans and investments together, relative to the bank's capacity as reflected by the dollar value of deposits.
  - Benchmarks would attempt to reflect local context, including the amount of community development financing activities by other banks in the assessment area.
  - Impact review would evaluate the impact and responsiveness of a bank's community development loan and community development investment activities through the application of a series of specific qualitative factors set forth in § __.15(b).

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Community Development Services Test

- The proposed test would consist of a primarily qualitative assessment of the bank's community development service activities. § __.25.
- For large banks with assets of over $10 billion, the agencies would also use a metric to measure the hours of community development services activity per full time employee of a bank. § __.25(b)(2).

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Community Development Financing Test for Wholesale Banks

- A qualitative review of a bank's community development lending and investments in each assessment area.
- Institution level-metric measuring a bank's volume of activities relative to its capacity. § __.26(d).
    - The numerator of the metric would be the dollar volume of qualifying community development loans and investments.
    - The denominator in this metric would be a bank's asset size, <u>not</u> its deposit volume (which is the denominator in the community development financing metric for large banks).
- Option to have examiners consider community development service activities that would qualify under the Community Development Services Test.

Community development definitions

- The NPR would incorporate aspects of the current interagency Q&A and include eleven defined categories for community development activities. § __.13(a)(2), (b) – (l).
- The agencies would use a "primary purpose" standard for determining eligibility of community development activities. § __.13.
    - In general, activities with a primary purpose of community development would receive full CRA credit.
    - An activity would meet the primary purpose standard if a majority of the dollars, applicable beneficiaries, or housing units are for one or more of the defined community development activities.
    - If the measurable portion of any benefit bestowed or dollars applied to the community development purpose is less than a majority, an activity may still receive credit under circumstances specified in Section __.13(a)(ii).
- *Pro rata* consideration would be given for certain affordable housing activities as specified in Section __.13(a)(1)(i)(A).
- The NPR seeks feedback on whether other community development activities should receive *pro rata* consideration.

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Qualifying Activities and Illustrative List of Activities

- Currently, the agencies typically do not provide advance assurance that an activity is a qualifying community development activity.
- Section __.14(a) of the NPR would establish a publicly available, illustrative, non-exhaustive list of activities eligible for community development consideration.
- The agencies would also establish a process for periodically updating this list.
- Sections __.14(c) and (d) would establish a process for banks to request that the agencies confirm in advance the eligibility that specific activities qualify for community development consideration.

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Strategic Plans

- The NPR would maintain a strategic plan option as an alternative method for evaluation. § __.27.
- Banks approved to be evaluated under a strategic plan would have the same assessment area requirements as other banks and would submit plans that include the same performance tests and standards that would otherwise apply, unless the bank is substantially engaged in activities outside the scope of these tests.
- In seeking approval for a plan that does not adhere to requirements and standards that are applied to other banks, the plan would be required to include an explanation of why the bank's view is that different standards would be more appropriate in meeting the credit needs of its communities.

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Assigned Conclusions and Ratings

- In general, the agency will assign conclusions for a bank's performance under the respective performance tests. The ratings will be "Outstanding," "High Satisfactory," "Low Satisfactory," "Needs to Improve," or "Substantial Non-compliance."
- The overall performance of a bank will be rated at the state, multi-state MSA and institution level under "Outstanding," "Satisfactory," "Needs to improve," or "Substantial non-compliance."
- States and multi-state MSAs – the agency will evaluate a bank's performance in any state where the bank maintains one or more facility-based assessment areas; the agency will disregard a bank's activities in that state that take place in the portion of the state comprising any multi-state MSA which will be evaluated separately.

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Assigned Conclusions and Ratings, cont.

- Effect of evidence of discriminatory or other illegal practices: at the state, multi-state MSA and institution levels, the agency's evaluation of a bank's performance will be adversely impacted by evidence of discriminatory or other illegal practices, including discrimination against applicants in violation of the Equal Credit Opportunity Act or the Fair Housing Act, violations of the Home Ownership and Equity Protection Act, violations of Section 5 of the Federal Trade Commission Act, unfair, deceptive or abusive acts or practices in connection with consumer financial products or services, violations of the Real Estate Settlement Procedures Act, violation of the Truth and Lending Act. § __.28(d).
- The agency will consider the root cause or causes of any violations of law, the severity of consumer harm, duration, pervasiveness, and the degree to which the bank has established an effective compliance management system to self-identify such risks.
- Consideration of past performance – On assigning ratings, the agency will consider a bank's past performance. If the prior rating was "needs to improve," the agency may determine that a "substantial non-compliance" rating is appropriate where the bank failed to improve its performance. § __.28(e).
- Small Banks – Separate standards for the performance of small and intermediate-sized banks are established in the regulations. Small banks could choose to continue being evaluated under the current lending test.

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Effect of CRA Performance on Applications

- CRA Performance – The agency will take into account the record or performance under the CRA in considering applications for:
  - Establishment of a domestic branch;
  - Relocation of the main office or a branch;
  - Merger or consolidation with or the acquisition of assets or assumption of liabilities of an insured bank requiring approval under the Bank Merger Act.
  - Conversion of an insured bank to a national bank or a federal savings association charter.
- Charter Application – An applicant for a new charter must submit a description of how it will meet its CRA objectives; the agency will consider this description in reviewing the application and may deny or condition approval on that basis.

Data Collection, Reporting, and Disclosure

- Large banks would be required to collect, maintain, and report additional data, including community development financing data, branch location data, and remote service facility location data. § __.42.
- Large banks with assets of over $10 billion would have data requirements for deposits data, automobile lending data, retail services data on digital delivery systems, retail services data on responsive deposit products, and community development services data.
  - Large banks with assets of less than $2 billion would not be required meet these data requirements—but would not be able to request additional consideration for certain activities if they do not meet the data requirements.
- Data requirements for intermediate banks and small banks would remain the same as the current requirements.

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Disclosure of HMDA Data by Race and Ethnicity

- For large banks, the NPR would require examiners to include in public CRA performance evaluations the distribution of race and ethnicity of a large bank's home mortgage loan originations and applications in each of the bank's facility-based assessment areas, and as applicable, in its retail lending assessment areas. §__.42(j).
- The proposed rule states this would have no direct impact on the conclusions or ratings of the bank. §__.42(j)(3).
- However, the NPR acknowledges it could lead to increased fair lending and redlining scrutiny.

Transition and Timeline

- The NPR comment period closed on August 5, 2022; the agencies received nearly 5,000 comments.
- General Rule: New rules would be effective on the first day of the first calendar quarter which is at least sixty days after publication of final rule.
- Exceptions: Start date for CRA examinations under the new tests: Two years from date of publication of the final rule.
- Consideration of Previous Bank Activities: In assessing a bank's CRA performance, the agency will consider any loan, investment or service that was eligible for CRA consideration at the time the bank conducted the activity and will consider any loan or investment eligible for CRA consideration at the time a legally binding commitment was entered into.

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Key Challenges

- Adapting to new assessment areas and products
    - Accurately separating covered areas between facility-based, retail-lending, and outside retail lending will require aggregating lending data and mapping it against MSAs to identify qualified areas
- Developing and executing on an implementation plan
    - Banks will need to implement a significant overhaul of their policies, products, systems, and procedures.
- Collecting and reporting both qualitative and quantitative data
    - Once the rule is enacted and updated policies, products, systems, and procedures are in place, Banks will need to continue to collect, analyze, and report the data. Banks will need to conduct and carry out monitoring frequently so they can make any required program adjustments timely

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What Can Banks Do To Prepare?

- Establish Working Groups: Identify the key stakeholders who will be needed to make decisions and drive progress
- Evaluate Technology: Analyze the current-state capabilities of your systems to identify potential technology updates that may help streamline the process of capturing the new CRA data requirements
- Identify the Scope: Assess your organization’s product offerings and areas of business (branch based and digital based) to determine the scope of impact for retail lending transactions
- Perform Gap Analysis: Evaluate covered areas, applications, and data collection practices against CRA requirements to determine areas needing updates to achieve compliance
- Regulators are expected to give banks ~12 months to become compliant once the rule is finalized. Banks will need to act sooner rather than later to ensure they are up and running and fully compliant with the new CRA rules

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DFS CRA Rulemaking

How will DFS respond to federal joint NPR?

- Historically, DFS CRA regulations have closely tracked the federal CRA regulations.
- Expectation is that DFS will – ultimately – amend its CRA regulations to follow new federal regulations.
- However, certain differences will remain, including new DFS minority- and women-owned business requirements.

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New York CRA Amendments

- In 2019, the New York legislature amended the New York CRA to require DFS to consider several aspects of banks’ activities with respect to minority- and women-owned businesses in CRA exams.
- The amendments were effective as of January 11, 2020, but DFS did not immediately revise examination procedures to cover activities relating to minority- and women-owned businesses.
- On June 30, 2020, DFS issued in industry letter describing the amendments and soliciting feedback on the nature and availability of data related to minority- and women-owned businesses.

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DFS Proposes Amendments to CRA Rules

- On November 3, 2021, DFS issued proposed amendments to its CRA regulations to address the legislature's minority- and women-owned business amendments.
- A minority-owned or women-owned business would be defined as a business more than 50 percent of the ownership or control of which is held by one or more minority individuals or women, respectively.
- The amendments would also require new data collection concerning minority-owned and women-owned businesses. (Proposed 3 NYCRR § 76.16.)
- The proposed amendments include a provision stating that DFS may determine that compliance with CFPB rules issued pursuant to Dodd-Frank Section 1071 constitutes compliance with the new DFS data collection rules. (Proposed 3 NYCRR § 76.16(g).)

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CFPB Small Business Data Collection and Reporting Rulemaking (Dodd-Frank Section 1071)

Background and Expected Timeline

- The purpose of Section 1071 **is to facilitate enforcement of fair lending laws and enable communities, governmental entities, and creditors** to identify business and community development needs and opportunities for women-owned, minority-owned, and small businesses.
- On September 1, 2021, the **CFPB issued their Notice of Proposed Rulemaking (NPRM) regarding section 1071,** which was open for public comment for 90 days following its publication in the Federal Register. The CFPB received more than 2000 comment letters. The NPRM laid out various definitions (e.g., a "covered financial institution“), provided requirements related to collecting and reporting data, and outlined notices which the financial institution will be required to provide to the applicant as part of the application process, among other items.
- The scope of the proposed rule is broad and would impact numerous financial institutions that provide small business credit. **Any entity that originates at least 25 small business credit transactions in each of the two preceding calendar years** would be required to **collect, maintain, and submit credit application data to the CFPB on an annual basis**. This data will include fields which some financial institutions already capture as part of the credit application and some newer fields, such as race, ethnicity, and sex of the principal owners.
- Similarities can be drawn between the requirements for HMDA data submission and those that are being proposed for Section 1071, with the exception that **Section 1071 covers a variety of small business credit products, including term loans, lines of credit, business cards, and merchant cash advances,** which greatly increases the number of financial institutions impacted by the proposed rulemaking.
- According to the CFPB, **the final rule would become effective 90 days after publication in the Federal Register**; however, **compliance would not be required until approximately 18 months after publication.**
- A court order requires the CFPB to **finalize the rule by March 2023.**

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Potential Implementation Challenges

- Risk Management & Compliance:
  - Understanding nuanced differences between HMDA and Section 1071 requirements.
  - Identifying the population of covered credit transactions and applications that will need to meet compliance.
  - Identifying and measuring risks associated with the CFPB's planned data publication.
- Governance:
  - Documenting clear process flows and procedures.
  - Providing and conducting adequate training for employees.
- Third-Party Oversight:
  - Managing data received from third-party loan originators to ensure data is accurate and compatible with 1071.
- Systems & Applications:
  - Identifying systems and applications that will be impacted by the ruling.
  - Identifying systems enhancements that will need to be made to comply with the ruling (e.g., firewall provision).
- Data Management:
  - Implementing consistency in data collection and data storage processes across various lines of business, products, and services to enable data consolidation and appropriate data reporting.
  - Maintaining data quality and performing data cleaning on compiled data to ensure the data is complete and accurate and compatible with the CFPB's submission portal.
  - Identifying and resolving data collection and data reporting issues.

CRA and 1071 Timeline Overlap

- The CFPB is required to finalize its Section 1071 rule by March, 2023.
- Expectation is that federal agencies will also finalize CRA rule sometime in 2023.
- Compliance date for both rules will likely by in mid to late 2024, with strong possibility that the compliance dates will be synchronized to allow for crossover between data collection requirements.

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Questions?

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