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Community Reinvestment Act

Treasury Releases CRA Reform Recommendations Focused on Assessment Areas, Examination Clarity and Flexibility, Examination Processes, and CRA Performance

SUMMARY

On April 3, the U.S. Department of Treasury (“Treasury”) issued a memorandum (the “Memorandum”) to the Office of the Comptroller of the Currency (the “OCC”), the Board of Governors of the Federal Reserve System (the “FRB”), and the Federal Deposit Insurance Corporation (the “FDIC” and, together with the OCC and the FRB, the “CRA Regulators”) setting forth findings and recommendations resulting from Treasury’s review of the Community Reinvestment Act (“CRA”) examination and ratings framework.¹ In the course of Treasury’s review, it consulted with nearly 100 stakeholders, including the CRA Regulators, community and consumer advocacy groups, academics, think tanks, financial institutions, trade associations, and law firms.

The Memorandum expresses Treasury’s continued support for the CRA’s fundamental purpose to encourage banks and other insured depository institutions (together, “Regulated Institutions”) to meet the credit and deposit needs of the communities in which they operate, including low- and moderate-income (“LMI”) communities.² It makes recommendations that can be implemented mostly, if not entirely, without statutory change. These recommendations are intended to further the original purpose of the CRA while reducing the “complexity and burden on banks, regulators, and community advocates.”³

The CRA Regulators have developed similar, though not identical, regimes for examining and rating the levels of CRA-eligible lending, investments, and services offered by the Regulated Institutions subject to their regulation and oversight.⁴ The Memorandum addresses these interagency differences and also notes that, although the “U.S. banking industry has experienced substantial organizational and technological changes; ... the regulatory and performance expectations under [the] CRA have not kept

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pace.”⁵ As a result, Treasury maintains that the current regulatory and performance expectations are outdated, unclear, and overly subjective. Comptroller of the Currency Joseph Otting has publicly indicated that the CRA Regulators plan to propose an “interagency redo” of the CRA Rules in the near future.⁶ The Memorandum may provide some insight into what these forthcoming proposals might entail.

Treasury’s review and recommendations focus on four broad topics, discussed in further detail below.

A. ASSESSMENT AREAS

Regulated Institutions are currently required to delineate geographic assessment areas within which the applicable CRA Regulator evaluates the Regulated Institution’s CRA performance. The CRA concept of assessment areas, however, “originated ... when there was no interstate banking and deposits almost always came from the community surrounding a branch.”⁷ The Memorandum argues that, today, this outdated concept results in CRA obligations that do not serve the needs of the relevant communities in which a Regulated Institution operates, or sufficiently target the needs of LMI communities. CRA Regulators have acknowledged that the evolution of financial technology has significantly changed the way financial products and services are accessed and that these innovations have the potential to promote financial inclusion and access to credit.⁸ Thus, Treasury recommends that “the CRA’s concept of community should account for the current range of alternative channels that exist for accepting deposits and providing services”⁹ and should reflect the extensive interstate and nationwide operations of many Regulated Institutions. Ideally, the framework for determining assessment areas would ensure that Regulated Institutions receive credit for CRA activities “within their branch and deposit-taking footprint” as well as for CRA activities in other LMI communities.¹⁰ Treasury believes that such an approach could be applied effectively to traditional banking organizations using alternative delivery channels, wholesale and limited purpose banks, and emerging “branchless” banks.¹¹

B. EXAMINATION CLARITY AND FLEXIBILITY

Treasury reviewed the current CRA performance evaluation processes and current examination guidance and found that such processes and guidance differ amongst the CRA Regulators and that there is additional variation in individual examiners’ application of CRA Regulators’ policies and procedures because “each examination is conducted within a bank’s particular performance context.”¹² Treasury notes that this lack of clarity is made more acute by the “long time lag between the examination period and the receipt of CRA ratings,”¹³ which leaves Regulated Institutions little time to adjust their activities for the next examination period. Treasury’s recommendations related to these topics include:

- expanding the types of loans, investments, and services eligible for CRA credit and establishing clearer standards for CRA eligibility that are consistent across each of the CRA Regulators;¹⁴
- allowing Regulated Institutions to obtain a limited number of eligibility determinations with respect to specific products or activities in advance of their CRA examinations;¹⁵

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- clarifying the process for developing a Regulated Institution's performance context,¹⁶ specifically by involving the CRA Regulators' research and policy staff in such development in advance of CRA examinations;¹⁷
- establishing clear qualitative and quantitative criteria for grading CRA loans, investments, and services and a consistent, reportable "measurement" of CRA activity to allow for comparison of like Regulated Institutions;¹⁸ and
- developing a "modernized, forward-looking approach to the Service Test"¹⁹ that places less weight on the establishment and maintenance of full-service branches and acknowledges the increasing importance of alternative delivery systems.

C. EXAMINATION PROCESS

In addition to its substantive review of CRA examination criteria, Treasury recommends particular improvements to administrative aspects of the CRA examination process. In particular, Treasury recommends standardizing the CRA examination schedules across CRA Regulators—through statutory changes, if necessary—in order to prevent delays in the release of performance evaluations and shorten the time between CRA examination periods.²⁰

D. CRA PERFORMANCE

Although the CRA itself does not directly impose penalties for poor performance, a less than Satisfactory CRA rating will significantly restrict a Regulated Institution's expansionary activities, as regulators consider CRA ratings in their evaluations of applications for deposit facilities²¹ and the results of CRA examinations are made publicly available. In addition, the FRB considers CRA performance when evaluating transactions subject to the Bank Holding Company Act,²² and, in order for a bank holding company to qualify as a financial holding company, all Regulated Institutions controlled by such bank holding company must have obtained a CRA rating of Satisfactory or better.²³ With respect to CRA performance, Treasury's recommendations include:

- adopting uniform guidance regarding the impact of evidence of consumer protection law violations on Regulated Institutions' CRA ratings—Treasury supports the framework articulated by the OCC in its recently updated Policies and Procedures Manual ("PPM") which considers (i) whether there is a logical nexus between a Regulated Institution's CRA rating the evidence of consumer protection law violations and (ii) any remedial action taken by the Regulated Institution;²⁴
- ending the practice of delaying the release of CRA performance evaluations due to pending consumer protection law investigations or enforcement actions;²⁵
- adopting policies and procedures that align with the OCC's recent PPM update setting forth a four-factor analysis for determining the impact of less than Satisfactory ratings on a Regulated Institution's expansion plans—in particular, a less than Satisfactory rating should *not* result in the automatic denial of a Regulated Institution's expansion application;²⁶
- clarifying that the use of a community benefit plan to address adverse public comments on merger or acquisition applications or for general remediation purposes is a tool a Regulated Institution can use to demonstrate how it will meet the needs of the community, but is *not* required for approval of a Regulated Institution's application;²⁷ and

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- amending the CRA regulations to allow Regulated Institutions to store the required public file on their websites, provided that any party who so requests is given access to a physical copy.²⁸

E. ADDITIONAL ITEMS

Treasury identifies certain additional issues that, although not raised by stakeholders, it finds “warrant further exploration by the CRA [R]egulators.”²⁹ Treasury’s recommendations with respect to these self-identified issues include:

- giving community development loans the same annual consideration as community development investments (rather than a one-time credit for the year of origination);³⁰
- evaluating the approach to the inclusion or exclusion of affiliate activities in performance evaluations;³¹ and
- reviewing the disparate capital treatment of certain public welfare investments under the Comprehensive Capital Analysis and Review framework.³²

OBSERVATIONS AND IMPLICATIONS

Since the CRA’s enactment, the CRA Regulators have developed and refined the CRA examination and rating framework through regulations, interagency guidance, and agency-specific policies and practices. The Memorandum highlights the fact that Treasury continues to view the general purpose of the CRA—to encourage Regulated Institutions to meet the credit needs of the communities in which they operate, including LMI neighborhoods, consistent with safe and sound banking operations³³—to be an important aspect of overall banking industry regulation. The Memorandum and its recommendations also acknowledge Treasury’s recognition of the widely held view that the CRA framework has become outdated and is inconsistently implemented.

The Memorandum reflects the input Treasury sought and received from both industry representatives and consumer advocacy groups, drawing from discussions and recommendations from both sides. For example, stakeholders broadly agreed, and Treasury recommends, that the definition of assessment area be updated to reflect the modern banking industry’s increasing use of alternative delivery systems, suggesting that assessment areas should capture activities where branches are geographically located *and* where lending and other services are actually provided.³⁴ Similarly, both the banking industry and consumer advocacy groups recommended the development of a process through which stakeholders can obtain advance determinations of CRA eligibility for unique or innovative products or activities, a recommendation Treasury includes in the Memorandum.

With respect to issues on which stakeholder groups disagreed, Treasury does not always provide definitive recommendations. For example, the banking industry advocated for the provision of CRA credit for projects that benefit entire communities (rather than specifically targeting LMI areas), for activities outside of assessment areas, and for *any* volunteer service with a community development purpose (not solely service related to the provision of financial services),³⁵ while consumer advocacy groups argued

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specifically against any such changes.³⁶ Treasury does address the scope of CRA credit through its recommendation that the scope of CRA-eligible activities be expanded and that clearer eligibility standards be established, but does not draw any specific conclusions. Similarly, although Treasury accepts the banking industry's recommendation that "an Unsatisfactory CRA rating [should] not be a de facto bar to ... engaging in ... activities requiring regulatory approval,"³⁷ it does not go so far as to reject consumer advocacy groups' assertion that "performance on applications must remain a powerful incentive for banks to abide by their community reinvestment obligations."³⁸ Instead, Treasury recommends the uniform adoption of the OCC's recent PPM updates regarding the effect of CRA ratings on application approvals.³⁹ Similarly, the banking industry requested that CRA Regulators clarify that the "CRA will not be used as a general enforcement tool"⁴⁰ for consumer protection laws, while consumer advocacy groups argued that "fair lending reviews must be a rigorous part of the CRA exam"⁴¹ and that "[r]etroactive downgrades should ... be applied if non-federal agencies ... uncover evidence of widespread discrimination or other illegal activities."⁴² Treasury takes no definitive position, but recommends the adoption of uniform guidance and expresses support for the OCC's framework, as outlined in its PPM, for evaluating evidence of consumer protection law violations.⁴³ Stakeholders agreed that the current approach for identifying a Regulated Institution's peers for purposes of determining the Regulated Institution's performance context is inconsistently applied and lacks transparency. The banking industry recommended that Regulated Institutions be responsible for identifying their peer institutions, while consumer advocacy groups recommended that the CRA Regulators make the determination.⁴⁴ Treasury does not resolve this disagreement, recommending only "further reform to the use of performance context as part of a CRA examination"⁴⁵ and that "the research and policy staff of the CRA regulators be involved in developing the performance context."⁴⁶

Likewise, even some issues raised by both the banking industry and consumer advocacy groups are not fully addressed in the Memorandum. Most notably, despite substantial stakeholder agreement that CRA requirements should be expanded to nonbanks such as credit unions and financial technology firms, Treasury recommends only that the "impact of the increased market share of nonbanks" continue to be monitored.⁴⁷ Additionally, stakeholder groups were consistent in their recommendation for improved examiner training to reduce inconsistency in subjective decision-making, a topic Treasury addresses in the Memorandum but with respect to which it offers no specific recommendations.⁴⁸ Treasury also mentions, but makes no recommendations in response to, the banking industry's concerns regarding timing and community engagement challenges in developing and amending Strategic Plans⁴⁹ and consumer advocacy groups' concern that limited scope examinations of Regulated Institutions' non-metropolitan assessment areas lead to restricted access to capital and banking services in these areas.⁵⁰

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Although the Memorandum suggests that proposed changes to the CRA rating and evaluation framework may be imminent, it also suggests that any such changes are likely to be incremental in nature and affected through updates to regulations and agency guidance rather than through any fundamental statutory changes.

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ENDNOTES

- 1 U.S. Department of the Treasury, *Memorandum for the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation* (Apr. 3, 2018), available at <https://home.treasury.gov/sites/default/files/2018-04/4-3-18%20CRA%20memo.pdf> (hereinafter, the “Memorandum”).
- 2 12 U.S.C. § 2901 *et seq.*
- 3 Memorandum, at 2.
- 4 The CRA implementing regulations are located at 12 C.F.R. parts 25 and 195 (OCC), 228 (FRB) and 345 (FDIC). Because the section references are substantially the same across the various parts, citations herein will be to the regulations in 12 C.F.R. part 25.
- 5 Memorandum, at 1.
- 6 Allison Bisbey, *New CRA Proposal Scheduled for Release in March: OCC’s Otting*, American Banker (Feb. 27, 2018), available at <https://www.americanbanker.com/news/new-cra-proposal-scheduled-for-release-next-month-occs-otting>; see also Steve Cocheo, *The Otting Effect*, Banking Exchange (March 14, 2018), available at <http://www.bankingexchange.com/news-feed/item/7425-the-otting-effect>.
- 7 *Id.*
- 8 Randal K Quarles, Vice Chairman for Supervision, Board of Governors of the Federal Reserve System, *The Roles of Consumer Protection and Small Business Access to Credit in Financial Inclusion* (March 26, 2018), Speech at the HOPE Global Forums Annual Meeting, Atlanta, Georgia, available at <https://www.federalreserve.gov/newsevents/speech/quarles20180326a.htm>.
- 9 *Id.* at 5.
- 10 *Id.* at 6.
- 11 *Id.*
- 12 *Id.*
- 13 *Id.* at 7.
- 14 *Id.* Treasury suggests that “by expanding the types of loans, investments, and services eligible for CRA credit ... the timeliness of ratings can improve.” *Id.* at 8.
- 15 Memorandum, at 8.
- 16 A bank’s performance context, as currently defined, takes into account factors such as: demographic and economic data; the community-specific lending marketplace; investment and service opportunities in the assessment area; the bank’s product offerings and business strategy; and the bank’s institutional capacity and constraints that affect its ability to meet the needs of the assessment area. 12 C.F.R. 25.21(b).
- 17 Memorandum, at 9.
- 18 *Id.* at 11-12.
- 19 *Id.* at 15.
- 20 *Id.* at 18. There is no prescribed period in which the CRA Regulators must release performance evaluations. Treasury found that, in practice, delays in the completion of evaluations are longer than the stated examination cycles of all CRA Regulators, and across banks of all sizes. Delays leave banks with dated CRA ratings and minimal time for responding to recommendations before their next performance evaluation begins. *Id.*

ENDNOTES (CONTINUED)

- 21 12 U.S.C. 2903. This provision includes new branch applications, relocation applications, merger and acquisition applications under the Bank Merger Act, and applications for charter conversions between regulators. 12 C.F.R. 25.29(a).
- 22 12 C.F.R. 228.29(a).
- 23 12 C.F.R. 225.82(c)(1).
- 24 Memorandum, at 20. For further information about the OCC's update to its Policies and Procedures Manual, please see our Memorandum to Clients entitled *OCC Issues Updated Policy for Determining the Impact of Discriminatory or Illegal Credit Practices on Community Reinvestment Act Ratings* (Oct. 13, 2017), available at https://www.sullcrom.com/siteFiles/Publications/SC_Publication_OCC_Issues_Updated_Policy_f_or_Determining_the_Impact_of_Discriminatory_or_Illegal_Credit_Practices_on_Community_Reinvestment_Act_Ratings.pdf.
- 25 Memorandum, at 20.
- 26 *Id.* at 21-22. The OCC described its four-factor framework in a November 8, 2017 PPM update. In determining whether to approve an application of a bank with a less than Satisfactory CRA rating, the OCC will consider: 1) the currentness and severity of the rating and the bank's progress in addressing the underlying issues; 2) whether approval of the application would result in a material increase in the size of the bank or the scope of its activities; 3) whether and to what extent approval of the application would benefit the communities to be served; and 4) whether approval of the application would ensure that the bank will be able to meet its CRA objectives, advance the goals of the CRA or significantly further fair access to banking services. See OCC, *Policies and Procedures Manual*, PPM 6300-2, available at <https://www.occ.treas.gov/publications/publications-by-type/other-publications-reports/ppms/ppm-6300-2.pdf>.
- 27 Memorandum, at 22.
- 28 *Id.* at 23. A bank must maintain a public file of CRA-related information at its main office and at a branch in each state in which it operates. 12 C.F.R. 25.43(c)(1).
- 29 Memorandum, at 23.
- 30 *Id.* at 24.
- 31 *Id.*
- 32 *Id.* at 25.
- 33 12 C.F.R. 25.11(b).
- 34 American Bankers Association, *CRA Modernization: Meeting Community Needs and Increasing Transparency* (Dec. 2017), available at <https://www.aba.com/Advocacy/Documents/CRA-WhitePaper2017.pdf> (hereinafter, "ABA Letter"), at 5-6; National Community Reinvestment Coalition, *Letter to Treasury: Strengthening the Community Reinvestment Act* (Feb. 5, 2018), available at <https://ncrc.org/letter-to-treasury/> (hereinafter, "NCRC Letter").
- 35 See ABA Letter, at 2-5.
- 36 See NCRC Letter.
- 37 ABA Letter, at 13.
- 38 *Id.*
- 39 Memorandum, at 19-20.
- 40 ABA Letter, at 13.
- 41 NCRC Letter.

ENDNOTES (CONTINUED)

- 42 *Id.*
- 43 Memorandum, at 20.
- 44 ABA Letter, at 9; NCRC Letter.
- 45 Memorandum, at 9.
- 46 *Id.*
- 47 *Id.* at 25.
- 48 *Id.* at 12.
- 49 *Id.* at 12-14. Strategic Plans serve as an alternative to traditional CRA examinations, allowing banks with unique business models and/or highly competitive assessment areas to establish, in consultation with community representatives, their own performance goals and criteria, subject to the approval of the relevant CRA Regulator. Stakeholders cited the amount of time that must be dedicated to community engagement and the lengthy approval process as deterrents to the use of the Strategic Plan option. *Id.* at 13.
- 50 *Id.* at 18. Examiners may, in their discretion, designate assessment areas as limited scope. Areas so designated receive less detailed examinations and do not significantly impact a bank's overall rating or rating for individual states. *Id.*

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