

October 13, 2017

## OCC Issues Updated Policy for Determining the Impact of Discriminatory or Illegal Credit Practices on Community Reinvestment Act Ratings

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### **OCC Issues *Policies and Procedures Manual* Update Setting Forth a Framework for Determining the Effect of Evidence of Discriminatory or Other Illegal Credit Practices on CRA Ratings for OCC-Supervised Institutions**

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On October 12, the Office of the Comptroller of the Currency (“OCC”) issued a bulletin<sup>1</sup> announcing revisions to its *Policies and Procedures Manual* (“PPM”),<sup>2</sup> which outlines the OCC’s policy and framework for determining the effect of evidence of discriminatory or other illegal credit practices on the Community Reinvestment Act (“CRA”) evaluation and assigned rating of national banks, federal savings associations, and federal branches. The OCC’s regulations governing CRA assessments require an evaluation of the bank’s record of helping to meet the credit needs of its assessment areas through its lending activities, and these revisions to the PPM help restore regulatory balance by ensuring that CRA compliance is assessed according to the intended purpose of the CRA rather than as a “catch all” secondary mechanism to enforce consumer compliance. These regulations tie CRA evaluations specifically to CRA lending performance, providing that “[t]he OCC’s evaluation of a bank’s CRA performance is adversely affected by evidence of discriminatory or other illegal credit practices in any geography by the bank or in any assessment area by any affiliate *whose loans have been considered as part of the bank’s lending performance.*”<sup>3</sup> Because the OCC has “discretion to determine how a bank’s CRA evaluation and rating are adversely affected”<sup>4</sup> by such evidence, the updated PPM signals the OCC’s current approach to

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exercising such discretion by providing public guidance to examiners of banking organizations examined by the OCC.

This release, issued only by the OCC, represents an important departure from recent practice and prior guidance released on an interagency basis by the Federal banking agencies in 2016.<sup>5</sup> The PPM provides that the OCC “only considers lowering the composite or component performance test rating of a bank if the evidence of discriminatory or other illegal credit practices *directly relates to the institution’s CRA lending activities*.”<sup>6</sup> By contrast, the discussion in the 2016 interagency guidance of such practices is not limited to practices that “directly relate” to the institution’s CRA lending activities. The 2016 interagency guidance provides that “an institution engages in discriminatory credit practices” within the meaning of Section 28(c) of the agencies’ respective CRA regulations “if it discourages or discriminates against credit applicants or borrowers on a prohibited basis, in violation, for example, of the Fair Housing Act or the Equal Credit Opportunity Act” and includes examples of “other illegal credit practices” inconsistent with the CRA (such as violations of Section 5 of the Federal Trade Commission Act).<sup>7</sup> The PPM notes that tying a CRA rating downgrade to CRA lending activities “ensures that the CRA evaluation does not penalize a bank for compliance deficiencies or illegal credit practices unrelated to its CRA lending activities.”<sup>8</sup>

The OCC’s “general policy” set forth in the PPM is to use the CRA performance evaluation “as a tool to achieve the underlying purposes of the CRA: to encourage banks to help meet credit needs ... in the communities in which they operate,” which should, in turn, “inform[] how examiners ... determine the adverse effect evidence of discriminatory or other illegal credit practices in a bank’s CRA lending activities has on a bank’s CRA evaluation ...”<sup>9</sup> In accordance with this general policy, the OCC’s determination in this regard will be guided by two principles: (1) there must be a “logical nexus” between the assigned ratings and evidence of discriminatory or other illegal credit practices in the bank’s CRA lending activities to ensure alignment between the ratings and the bank’s actual CRA performance; and (2) full consideration is given to the remedial actions taken by the bank.

With respect to the first principle, where evidence of such practices directly relates to a bank’s CRA lending activities, the OCC examiners will assess the “extent and strength” of such evidence. This means, for example, that adverse actions taken in response to “limited, technical, or immaterial” instances of such practices “in the context of otherwise good-to-excellent performance under each of the performance tests” may be limited to criticizing the practice in the CRA performance evaluation.<sup>10</sup> By contrast, adverse actions taken in response to “more material instances” of such practices “in the context of average-to-good performance” may include lowering a component performance test rating by one level.<sup>11</sup> To downgrade a composite rating, OCC examiners must present “strong evidence of quantitatively and qualitatively material instances of discriminatory or illegal credit practices directly related to CRA lending activities that have resulted in material harm to customers.”<sup>12</sup> The goal of this

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assessment approach is to “ensure that the bank’s CRA [performance evaluation], including the assigned rating(s), reflects the bank’s actual performance.”<sup>13</sup> The release also notes that the decision may be affected by the “cumulative impact of supervisory or enforcement actions taken against a bank.”<sup>14</sup>

With respect to the second principle, the PPM notes that the OCC will assign CRA ratings in light of the bank’s entire record of performance (“including the cumulative impact of supervisory or enforcement actions taken against a bank”).<sup>15</sup> CRA ratings generally should not be lowered solely based on the existence of evidence of discriminatory or other illegal credit practices prior to commencement of the CRA evaluation if the bank has remediated or taken appropriate corrective actions to address them.<sup>16</sup> Examples of bank mitigating actions include the implementation of controls, testing or audit procedures, the payment of restitution to customers, and the voluntary self-identification of violations where corrective actions are taken in a timely matter.<sup>17</sup>

In order to lower a rating on the basis of evidence of such discriminatory or illegal practices, examiners will be required to “provide a full explanation” of the reasons why the identified practices should result in a lower rating, which must include a description of how the examiner applied the policies outlined in the PPM.<sup>18</sup>

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## OBSERVATIONS AND IMPLICATIONS

In recent years, the OCC and other Federal banking agencies have downgraded CRA composite ratings for a wide variety of consumer violations that do not relate to the institution’s CRA-related lending activities, frequently without detailed explanations of the basis for the downgrades. Because a downgrade in the composite rating to a “needs to improve” may preclude the institution from expansionary activities, such action may have a more significant impact on the organization than the underlying enforcement or supervisory action. The OCC’s updating of its policy on such downgrades implicitly acknowledges that the CRA ratings process should not be used in a punitive fashion. The emphasis on prompt remediation as reducing the risk of a downgrade that might otherwise be justifiable also provides a strong incentive for banking organizations to eliminate consumer violations that may affect their CRA process as fully and promptly as possible. Finally, the OCC’s policy requiring that examiners fully justify downgrades of components or composite ratings should result in a more consistent application of the relevant regulation.

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ENDNOTES

- 1 Office of the Comptroller of the Currency, OCC Bulletin 2017-40, *Impact of Evidence of Discriminatory or Other Illegal Credit Practices on Community Reinvestment Act Ratings* (Oct. 12, 2017), available at <https://www.occ.gov/news-issuances/bulletins/2017/bulletin-2017-40.html>.
- 2 Office of the Comptroller of the Currency, Bank Supervision, Policies and Procedures Manual, PPM 5000-43, *Impact of Evidence of Discriminatory or Other Illegal Credit Practices on Community Reinvestment Act Ratings* (Oct. 12, 2017), available at <https://www.occ.gov/publications/publications-by-type/other-publications-reports/ppms/ppm-5000-43.pdf> (hereafter, the “PPM”).
- 3 12 C.F.R. 25.28(c)(2); 12 C.F.R. 195.28(c) (emphasis added). Evidence of discriminatory or other credit practices that violate an applicable law, rule, or regulation includes, but is not limited to, evidence of violations of the Equal Credit Opportunity Act, Fair Housing Act, Home Ownership and Equity Protection Act, Section 5 of the Federal Trade Commission Act, Section 8 of the Real Estate Settlement Procedures Act, and the provision of the Truth in Lending Act regarding a consumer’s right of rescission.
- 4 PPM, at 2.
- 5 Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, and Federal Deposit Insurance Corporation, 12 C.F.R. Parts 25, 195, 228, *et al.*, Community Reinvestment Act; *Interagency Questions and Answers Regarding Community Reinvestment*; Guidance, 81 Fed. Reg. 48506, 48548, available at <https://www.gpo.gov/fdsys/pkg/FR-2016-07-25/pdf/2016-16693.pdf>.
- 6 PPM, at 3.
- 7 81 Fed. Reg. 48506, 48548. Indeed, the 2016 interagency guidance notes that “[v]iolations of other provisions of the consumer protection laws generally will not adversely affect an institution’s CRA rating, but may warrant the inclusion of comments in an institution’s performance evaluation.” *Id.*
- 8 PPM, at 3.
- 9 PPM, at 2.
- 10 PPM, at 3.
- 11 PPM, at 3.
- 12 PPM, at 3.
- 13 PPM, at 3.
- 14 PPM, at 3.
- 15 PPM, at 3.
- 16 PPM, at 4.
- 17 PPM, at 4.
- 18 PPM, at 4.

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