The OCC's Final CRA Rule Improves Upon the Proposed Rule but Remains Unsatisfactory

Laurie Goodman, Ellen Seidman, and Jun Zhu

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Congress passed the Community Reinvestment Act (CRA) in 1977 to ensure that banks adequately serve the needs of their entire community, including low- and moderate-income (LMI) neighborhoods. During the intervening years, and in response to massive changes in banking and community development, a complex regulatory scheme administered by three federal bank regulators has developed. But the underlying regulations were last significantly changed in 1995. At the end of 2019, the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) released a notice of proposed rulemaking (NPR) that would have effected a sweeping overhaul of the rules.[1] The Federal Reserve, the third federal bank supervisory agency, did not join the proposal. The comment period ended on April 9, 2020, and the two regulators received more than 7,500 letters. On May 20, the OCC alone issued a final rule.[2] The new rule will be effective for OCC CRA exams beginning in 2023.

The proposed rule suffered from four big problems.

- **There was no evidence of the proposed rule's impact.** The proposal included no data that would help the public understand the proposal's likely impact on banks' performance or the impact on the communities they serve.
- **The primary metric used for assessing CRA compliance neglected community needs.** The bank-level CRA evaluation metric, the rule's cornerstone, focused the evaluation of a bank's activities on the share of its bank-wide balance sheet that reflected "CRA-eligible activities," rather than on loans and investments made to serve community needs. In addition, the definition of "CRA-eligible activity" would have been greatly expanded to include items such as infrastructure investments. Banks would have had an incentive to meet CRA obligations by making large investments in projects that might have only limited impacts on the needs of LMI

communities and people. Moreover, the thresholds for specific presumptive CRA ratings that were set in the NPR would have, as we demonstrated in our comment letter, resulted in significant "grade inflation."[3]

- **The rule created limited and unforgiving testing on retail and community development lending, with limited community coverage.** The NPR included pass-fail retail and community development lending tests for activities conducted within a bank's assessment areas. The retail tests in particular were unforgiving. A bank's presumptive rating on the bank-level CRA evaluation metric would become "unsatisfactory" if the bank failed a single retail activity test. Because banks would be tested only for retail lines composing at least 15 percent of the bank's retail activities, some large banks that do significant business in one line, such as small business lending, would not be evaluated on that line because, for example, their combined home mortgage and consumer lending constituted more than 85 percent of their retail lending. And small institutions with a few assessment areas were at a considerable disadvantage. Failing one test in one assessment area could mean an overall unsatisfactory rating. Finally, the retail lending test's peer comparison and pass-fail structure could provoke a race to the bottom with banks making fewer loans over time.
- **Public data would be lost while bank reporting burdens would increase.** The NPR would have substantially increased the reporting burden on financial institutions while decreasing the information that would have been made available to the public, including public officials other than bank regulators. Individual bank data would have been made public only on a bank-wide basis, data on a countywide basis would have been aggregated for all banks, and no data would have been made public on a smaller-than-county basis, making it impossible to understand how well a bank is serving its communities.

The Final Rule Did Not Address These Four Weaknesses

The OCC did not address any of these big structural issues in the final rule. The OCC acknowledged, "Although commenters disagreed with the approach outlined in the proposal, the agency ultimately agreed with the minority of commenters who expressed support for the proposed framework."[4] Moreover, although the bank-wide CRA evaluation measure remained in place, the OCC postponed announcing the levels necessary to achieve a given rating to a later rulemaking. Coupled with a continuing lack of data about critical aspects of the rule, this makes it impossible to understand the rule's likely impact on CRA ratings and the extent of any grade inflation.

The retail lending and community development tests remain pass-fail. Although the OCC did allow for some examiner judgment to overrule a test result, it is not clear when this would be invoked. The final rule leaves the 15 percent threshold in place and limits each bank to two retail product lines, which means fewer banks will be subject to fewer tests, leaving more retail bank activity at the assessment area level unevaluated.

In addition, the final rule continues to require banks to collect extensive data while making no improvement in public disclosure.

Improvements in the Final Rule

The OCC did make some improvements. One of the proposal's strengths was allowing banks to receive preapproval to ensure an activity would "count" for CRA purposes. The final rule shortened the preapproval period from six months to 60 days, making it more practical.

While retaining the proposed rule's vast expansion of qualifying community development activities for CRA purposes, the final rule made several improvements. Where the proposal would have counted all infrastructure financing, infrastructure loans and investments under the final rule must partially or primarily benefit LMI borrowers. This is better but still troubling, especially given the large size of most infrastructure projects. The final rule deleted middle-income housing in high-cost areas as an eligible activity, while adding, at full committed value, standby letters of credit, which are often needed to develop affordable rental housing, especially in New York City. In addition, the rule added multipliers for CRA deserts and for complex and innovative transactions and added back activities that spur economic development and job retention and creation. Moreover, no multipliers would be applied until the raw amount of community development activities exceeds the amount in the prior exam period.

In the proposal, banks would have received only 25 percent credit for loans sold within 90 days. Under the final rule, banks will get credit for 100 percent of origination value during the year the loan is originated. This primarily benefits single-family mortgage lending, where many LMI loans are sold into securitizations. But the change still gives banks equal credit for making one home mortgage loan and holding it for its expected seven-year life or making seven loans and selling them within a year. In addition, the final rule added a geographic test for single-family mortgages and gave all retail loans generated by branches in LMI tracts a multiplier of 2.

On the retail lending and community development tests, the largest banks now have to pass in 80 percent of their assessment areas, while banks with fewer than five assessment areas need to pass in only 50 percent. Moreover, credit cards and overdraft products no longer count as retail loans. The final rule decreased small business and small farm thresholds to $1.6 million from the $2 million in the proposal—still higher than the current $1 million threshold for small business loans and $500,000 threshold for small farm loans. Moreover, examiners, not the banks, will conduct the retail lending tests.

The Final Rule Is Better but Inadequate

Although the final rule is somewhat improved around the edges, the core has many problems. Moreover, the fact that the FDIC has joined the Federal Reserve in rejecting the rule means that the nearly 80 percent of the nation's banks supervised by the FDIC and the Fed will be subject to one CRA regulatory regime, while the other 20 percent supervised by the OCC would be subject to another. The largest 121 OCC banks,[5] which hold about 65 percent of the country's bank assets, will be subject to a totally new set of CRA rules. Smaller OCC banks, with assets below the $2.5 billion cutoff, who choose not to opt into the new structure, would nevertheless get the benefit of the expanded definition of "what counts," unlike banks supervised by the FDIC or Federal Reserve. This will not only generate confusion for banks and their community partners but also enhance opportunities for regulatory arbitrage.

The final rule contains two other fatal flaws. First, because the data underlying much of it are still missing and the OCC delayed publication of the presumptive CRA rating thresholds, it continues to be impossible to evaluate the rule's potential impact. And second, although the final rule continues to add to the record-keeping burden for banks, it retains the proposed rule's substantial reduction in publicly available data. Thus, not only can we not predict the rule's potential impact on communities, but once it goes into effect, the public will still be in the dark.

Notes

1 Community Reinvestment Act Regulations, 85 Fed. Reg. 1204 (January 9, 2020).

2 Community Reinvestment Act Regulations, 85 Fed. Reg. 34734 (June 5, 2020).

3 Laurie Goodman, Ellen Seidman, and Jun Zhu, "OCC Docket ID OCC-2018-0008; FDIC RIN 3064-AF22," comment letter to Robert E. Feldman, executive secretary of the Federal Deposit Insurance Corporation, April 8, 2020, https://www.urban.org/sites/default/files/publication/102005/community-reinvestment-act-april-8-2020-comment-letter.pdf.

4 Community Reinvestment Act Regulations, 85 Fed. Reg. 34738 (June 5, 2020).

5 According to FDIC data, as of March 31, 2020, 121 banks supervised by the OCC had assets in excess of $2.5 billion and thus would be required to adopt the new CRA evaluation regime.

About the Authors

Laurie Goodman is vice president for housing finance policy at the Urban Institute.

Ellen Seidman is a nonresident fellow in the Housing Finance Policy Center at the Urban Institute.

Jun Zhu is a nonresident fellow in the Housing Finance Policy Center.

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500 L'Enfant Plaza SW
Washington, DC 20024

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