Community and Economic Development in North Carolina and Beyond Blog: Update on the Community Reinvestment Act

By CED Program Interns & Students

Article: https://ced.sog.unc.edu/update-on-the-community-reinvestment-act/

This entry was posted on February 14, 2019 and is filed under Community Development, Financing Development

The Community Reinvestment Act (CRA) was enacted in 1977 and charged federal bank regulators with the task of monitoring the banking industry's lending practices and community development investments in low- and moderate-income communities. The CRA was created to address banking industry practices known as "redlining", whereby some lenders would not issue loans in certain low-income, often predominantly minority communities, regardless of an applicant's creditworthiness. This blog post will discuss some of the functional elements of the CRA, its history, and the Treasury's recent recommendations for an update to the CRA.

Since its inception 42 years ago, the CRA has seen few updates, with the most recent overhaul in 1995. Following a 2017 report to the President, the Treasury Department issued recommendations for updates to the CRA in spring of 2018. Much of the recommendations center around finding ways to make CRA evaluations less subjective and more quantitative. Other recommended changes focus on the changing nature of the banking industry, and new contexts in which CRA assessments might be applied.

Photo source: marketwatch.com

CRA Background

Three federal banking agencies – the Federal Reserve Board (FRB), the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC) – work to monitor and rate banking compliance to the CRA. Though there are no direct penalties for poor CRA examinations, banks are incentivized to score highly on evaluations. Receiving ratings lower than "Outstanding" or "Satisfactory" can affect a bank's ability to open new locations as well as participate in mergers and acquisitions. Additionally, a bank's CRA evaluation is made available to the public. The implementation of the CRA has resulted in appreciable increases in investment and lending in low and medium- income communities as well as participation in community development investments such as Low-Income Housing Tax Credit investments.

In the 1995 overhaul, the CRA shifted from monitoring a bank's procedures to monitoring actual lending practices in low and middle-income communities. The update created compliance tests for financial institutions within three categories: large retail ($250 million in assets or having a parent company with $1 billion in assets), small retail, and limited purpose institutions (such as institutions only making one type of loan such as credit card providers). Financial institutions were also given the option to be examined against a "strategic plan" which the institution would create independently with community input and approval from regulators.   In the time since the strategic plan option became available, very few banks have opted for this route due to its significant community feedback requirements and other hands-on thresholds a bank must reach. These compliance tests are applied to an institution's "assessment area", which is a physical geography

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where the institution has a presence. For an in-depth analysis of the 1995 changes to CRA see this 2000 literature review from the Brookings Institute.

The remainder of this post will discuss some of the findings and recommendations of the 2018 Treasury memo. Generally, the memo outlined four key categories with recommended updates including:

- how CRA activity is measured
- harmonization of the various CRA supervision entities
- distribution of geographic assessment areas
- CRA examination processes

Assessment Areas

Regardless of a bank's size, the geographic area in which a bank has a presence or purchases a substantial number of loans is determined to be its "Assessment Area". The concept was created in the time before online banking and the dominance of national bank brands, when most financial institutions covered a limited geography.

In the case of limited purpose institutions, only the geography of headquarters and branch offices are considered for the creation of their assessment area, meaning these institutions do not need to make CRA investments in locations where a significant portion of their lending takes place. According to the Treasury memo, a large portion of these limited service banks are headquartered in Utah and Delaware, presumably due to their regulatory environment. Among its recommendations, Treasury noted that Assessment Areas should include Low/Median Income communities that might not contain physical bank locations, but from where a bank accepts significant deposits and does business. This recommendation is also carried over to limited purpose banks and the variety of "branchless" banks that the rise of online banking has brought about.

Examination Clarity and Flexibility

Another concern noted by Treasury centered on clarity and flexibility in CRA compliance examinations. The responsibility of compliance examinations falls to examiners from one of the three federal agencies discussed above, FRB, FDIC, or OCC. Additionally, there is some level of subjectivity while making compliance assessments in addition to having no formal channel for confirming a new lending activity's ability to receive CRA credit. This subjectivity and uncertainty were noted as potential limiting factors when a bank is considering a new lending activity, especially where complex and innovative new lines of lending are concerned, which may result in lower levels of lending that might assist in community development efforts.

Performance Context

One element of a bank's CRA evaluation is an assessment of a bank's performance in the context of the assessment area's economic conditions. This "performance context" is one point where a bank may provide feedback to assist a CRA examiner. The Treasury memo noted that this may lead to relatively subjective analysis of the economic conditions a bank operates within, and the subsequent potential for inconsistent review of performance. One recommendation laid out by treasury is to involve research and policy staff of the CRA regulators in building out consistent metrics for performance context before examinations are held.

This lack of quantitative clarity when evaluating CRA performance carries over to measuring quantity and quality of lending in a banks assessment area. According to the Treasury memo, "The CRA regulators recognize these challenges, yet stated that they are hesitant to provide specificity on scoring and rating determinations due to varying performance contexts and concerns that quantitative guidance could be perceived as the creation of federally mandated credit allocation requirements."

As the process around updating the CRA moves forward, more stakeholders will weigh in and offer recommendations. An update to the CRA will likely help provide clarity to lending institutions as well as make updates to address the changing nature of the banking industry while addressing community development needs.

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