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Updating Community Reinvestment Act Is Key for Financial Inclusion

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Modernizing the Community Reinvestment Act may easily be the most consequential bank regulatory action this year, says Morgan Lewis partner Robin Nunn. The proposal represents a major step forward for modernizing existing regulations to account for the growth of mobile and online banking, she says. She offers takeaways for attorneys representing banks and other financial institutions.

The Community Reinvestment Act (CRA) was last updated in 1995, and since then, the way we invest, spend, and save money has dramatically changed with technological advances in the payments sector. The CRA encouraged Federal Deposit Insurance Corp.-covered institutions to better serve their communities, including low- and moderate-income (LMI) neighborhoods, by increasing financial services in areas that need it most.

Fast-forward to May 5 when the Federal Reserve System, the FDIC, and the Office of the Comptroller of the Currency (OCC) issued a joint proposal to “strengthen and modernize regulations” implementing the CRA. The long-awaited proposed reform would finally give banks credit for online banking, adopt a metrics-based evaluation approach, stratify the assessment process of a bank’s size and activity, better define eligible CRA credit activities, and significantly increase the data collection and reporting requirements of some banks.

Modernizing the Act Has Been Difficult

Congress passed the CRA in 1977 to prevent banks from withholding loans or general banking services to individuals from low-income areas and/or associated with a certain racial or ethnic group, a practice known as “redlining.” Critics say that the act forces banks to engage in risky lending practices, while supporters argue that it is essential for financial access and inclusion for all Americans.

After a few false starts, the rulemaking process has resumed under the Biden administration. Despite the agencies’ coordinated efforts, the core challenge remains how to reshape the law’s obligations to account for the rise of digital finance.

The CRA currently regulates banks based on their physical location, which has zero relevancy for electronic banking. With this new proposal, regulators have sought to introduce more flexibility in how banks can meet their obligations.

Public comments are due Aug. 5, with a final rule expected within the next six to nine months.

Shift From Bank Branches to Digital Banking

Allowing banks to receive CRA credit for activities outside of their branch-based assessment areas could open the door to historic investment in places largely without bank branches, including poor, rural areas that are predominantly Black, Hispanic, and/or Native American communities. Many also fear, however, that too much flexibility could lead large swaths of the industry to pursue CRA projects where they are most profitable.

Thanks to the internet and the rise of online banking, banks are far less reliant on branches. Customers can make electronic payments and apply for loans from virtually anywhere, while CRA oversight remains frozen in time.

According to an FDIC report, 34% of people used smartphones as the primary method to access financial services, with another 22.8% using a computer. Between 2010-2019, the number of full-service bank branches fell from almost 95,000 to just over 83,000.

When choosing a new bank, only 30% of US adults cited having a nearby branch as a consideration, while mobile and online banking were cited by 48% and 36%, respectively.

Evaluations for CRA compliance rely on servicers having brick-and-mortar locations, specifically defined as "geographies where the bank has its primary office, branches, ATMs, and surrounding geographies in which the bank has originated or purchased a majority of its loans."

This, however, excludes digital lending, leaving out banks with partial or full online lending practices. The new retail lending assessment areas are intended to address this oversight by evaluating banks only under the retail lending test.

According to the proposal, if a bank's performance was judged by where it lent, and not by branch locations, it would result in 32% of examined lenders receiving a "needs to improve" score, compared to 16% earning that mark for their retail performance.

Legal Implications and Takeaways

CRA modernization may easily be the most impactful bank regulatory action this year. The proposal represents a major, collaborative step forward for modernizing existing CRA regulations by US banking regulators. Here are some takeaways for banks:

- **Speak Up.** FDIC institutions and other stakeholders should carefully review the proposal. Those impacted should consider responding to the 180 proposed questions, individually or through a representative like a law firm or trade association to help shape these substantial revisions.
- **Size Matters:** Banks should evaluate their size category since compliance obligations would vary under revised asset-size thresholds that would be adjusted for inflation annually.

- **Look Out, Large Banks:** The proposal may significantly impact large banks' compliance obligations, while granting smaller banks the option to continue complying under the existing framework. Large banks, particularly those with limited branches, may want to review their lending data to identify areas that would qualify as retail lending assessment areas, and determine how well their major product lines serve LMI individuals and communities. Large banks would be subject to additional reporting and recordkeeping requirements and may want to start gathering the tools to satisfy these obligations.
- **More Loans are Small Business Loans:** The proposal would raise the gross annual revenue threshold of $1 million or less to match the CFPB's definition of "small business" as $5 million, potentially resulting in substantially more considered as small business loans.

Since 1995, the way we invest, spend, and save money has dramatically changed with technological advances in the payments space. The CRA proposal may significantly impact the compliance obligations of large banks and others, while granting smaller banks the option of continuing to comply under the existing framework.

In light of the proposal, bank and non-bank lenders should start reviewing their lending data and assessing how they serve and provide access to low- to moderate-income communities, especially communities of color which continue to be impacted by the effects of the global pandemic and have historically faced significant hurdles in gaining access to credit.

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Author Information

Robin Nunn is a partner and co-leader of the Banking Industry Sector at Morgan, Lewis & Bockius LLP. She advises domestic and international banks, investment advisers, broker-dealers, mortgage servicers, and emerging financial services providers on complex litigation, regulatory, enforcement, and transactional issues.

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