NATIONAL COMMUNITY REINVESTMENT COALITION

NCRC

www.ncrc.org

ISSUE BRIEF | NOVEMBER 2014

Summary:
Proposed Changes to *Interagency Questions and Answers Regarding Community Reinvestment*

Summary:
Proposed Changes to *Interagency Questions and Answers Regarding Community Reinvestment*

The Office of the Comptroller of the Currency, the Federal Reserve Board, and the Federal Deposit Insurance Corporation (the "Agencies") recently released a proposed update to the Community Reinvestment Act Q&A. The Agencies regularly review examination policies, procedures, and guidance to better serve the goals of CRA. Following the publication of the full Q&A in 2010 and the additions released in 2013, the Agencies identified several areas that warrant additional guidance. After the Agencies have considered comments received on this proposal, they plan to formally adopt and republish new and revised Q&A.

The deadline for comment is November 10, 2014.

Overview and Analysis

Much of the proposal is focused on expanding and updating the CRA guidance to reflect new technological advancements in financial services. There is also an emphasis on clarifying the objectives of specific tests and standards that apply throughout CRA. **NCRC has identified the following key issues:**

1) There is a need to account for changes in banking technology and the ways customers engage with financial institutions. As a result of online and mobile technology, financial institutions can reach consumers in new ways. It must be made clear that financial institutions will not receive CRA credit even for the low- and moderate-income individuals and geographies that are reached through mobile or online technology that are outside their established assessment areas. Examiners must restrict their assessments to a financial institution's performance and services in that institution's assessment areas.

2) The provision of online and mobile services alone is insufficient. To warrant CRA credit, it must be clear that those services (1) are accessible to low- and moderate-income individuals and geographies; (2) that there is actual adoption of those technologies by low- and moderate-income individuals and geographies; (3) that those technologies are the preferred method of engagement; and (4) that those services are not the sole method for low and moderate-income individuals and geographies to engage financial institutions.

3) Regulators should not be awarding CRA credit for a financial institution's support for expanded broadband access. Broadband access is a growing need, especially in rural areas, and it is a clear priority for the current Administration. But giving CRA credit for supporting broadband expansion is problematic. It is more important to use CRA credit to encourage financial institutions to find more direct ways to meet the needs of LMI individuals and geographies.

4) We are encouraged by the Agencies' inclusion of using alternative credit histories as a practice that warrants CRA credit. Many existing underwriting practices effectively exclude a large number of creditworthy low- and moderate-income borrowers. Financial institutions will have a greater incentive to integrate alternative credit histories into their business with the added clarity that the practice is eligible for CRA credit.

All questions which the Agencies have specifically request commenters' views are included in the Appendix.

Summary of Proposed Revisions

ACCESS TO BANKING SERVICES:
Availability and Effectiveness of Retail Banking Services

The CRA regulations list the performance criteria examiners should consider when evaluating the availability and effectiveness of an institution's retail banking services under the service test. Agencies evaluate services based on the following criteria: (1) distribution of branches across all income areas; (2) the institution's record of opening and closing branches, especially in low- and moderate-income areas; (3) the availability and effectiveness of alternative systems for delivery to low- and moderate-income geographies and people; and (4) the range of services provided across all income geographies and whether those services meet the needs of those geographies.

Existing Guidance: The service test performance standards place primary emphasis on full service branches while still considering alternative systems like ATMs. As a result, examiners have focused primarily on an institution's branching activities when evaluating an institution's performance under the service test.

KEY CHANGES

The Agencies propose:

- Deleting language that states "performance standards place primary emphasis on full service branches."
- Deleting the statement that provides that alternative systems are considered "only to the extent" that they are effective alternatives in providing needed services to low- and moderate-income geographies and individuals.

ANALYSIS

Alternative delivery systems are a growing phenomenon that must be discussed in greater detail in CRA guidance. But these systems are not, and should not be, a replacement for full service branches. Before moving away from placing primary emphasis on full service branches, it must be shown that these alternative systems are available, accessible, and utilized by low- and moderate-income individuals and geographies. Moreover, they must not be the only method of interacting with a financial services institution.

Alternative systems should receive greater consideration under the regulations' service test when they are effective in delivering retail banking services to low- and moderate-income individuals. It is not clear that awarding CRA credit for reaching all consumers with these systems, and not maintaining a focus on low- and moderate-income consumers, aligns with the purpose and intent of CRA. The primary emphasis should remain on meeting the needs of those traditionally underserved households and communities.

ACCESS TO BANKING SERVICES: Alternative Systems for Delivering Retail Banking Services

Existing Guidance: There are several ways an institution can provide retail banking services. The existing guidance lists ATMs, banking by telephone or computer, and banking by mail as examples of alternative delivery systems. The Q&A states that delivery systems "other than branches will be considered under the regulation to the extent that they are effective alternatives to branches in providing needed services to low and moderate-income areas and individuals."

KEY CHANGES

The Agencies propose:

- Including a non-exhaustive list of examples of alternative delivery systems that reflect current technological advances in the industry.

- Providing further guidance on factors that examiners use to evaluate whether alternative delivery systems are an available and effective means of providing retail banking services to low- and moderate-income geographies and individuals, including:
  - Ease of access, physical or virtual;
  - Cost to consumers vs. other delivery systems;
  - Range of services delivered;
  - Ease of use;
  - Rate of adoption; and
  - Reliability of systems.

- Clarifying that they do not intend that every feature or factor would need to be satisfied for an institution's alternative systems to be considered available and effective.

- Stating that financial institutions could provide available data on consumer usage or transactions and the other factors outlined above to demonstrate the availability and effectiveness of the institution's alternative delivery systems to demonstrate that the systems are available to, and used by, low- and moderate-income individuals.

ANALYSIS

Even with the presence of alternative delivery systems, CRA credit should only be awarded within an institution's assessment area and it should only be awarded if an institution can demonstrate definitively that these alternative delivery systems are accessible to, and actually being used by, low- and moderate-income geographies and individuals. Alternative delivery systems are not a perfect substitute for branch locations, and they must not be the only way low- and moderate-income individuals and households and geographies have available to interact with financial institutions. The further guidance proposed by the Agencies helps clarify that these concerns must be addressed, but it is not sufficient. It must be clear to examiners that these systems are not a substitute.

INNOVATIVE OR FLEXIBLE LENDING PRACTICES

Under the performance standards for large financial institutions, an institution's use of innovative or flexible lending practices is one of five factors reviewed as part of the lending test.

Existing Guidance: An examination of innovativeness is not limited to the variety of products available, or the specific terms of those products. An examiner may also consider practices that enhance the success and effectiveness of the community development loan program or lending programs that address the credit needs of low- and moderate-income geographies or individuals. Current guidance includes two examples: (1) a technical assistance program for loan recipients administered in conjunction with a community development loan program for loan recipients, and (2) a contracting program for small business borrowers established in connection with a small business lending program.

KEY CHANGES

The Agencies propose:

- Expanding the list of examples of innovative or flexible lending practices, including:
  - Small dollar loan programs offered in conjunction with outreach initiatives that include financial literacy or a savings component; and
  - Mortgage or consumer lending programs that utilize alternative credit histories in a manner that would benefit low- or moderate-income individuals.
- Clarifying that innovative or flexible lending practice is not required to obtain a specific rating, but rather is a qualitative consideration that can enhance an institution's CRA performance.

ANALYSIS

Small dollar loan programs offer a promising alternative to higher-cost loans offered by institutions like payday lenders. And with the financial literacy and savings components, these loan programs offer real opportunities to help build sustainable wealth and financial knowledge. It must be clear to examiners, however, that these small dollar loan programs should only be awarded credit if they are safe and sound alternatives to high-cost and/or predatory products.

It is also encouraging to see the Agencies clearly identify loan programs using alternative credit histories to earn CRA credit. Multiple studies have shown that a disproportionate share of low- and moderate-income individuals are left out of traditional credit scoring models and traditional trade credit lines, yet are fully capable of handling credit and monthly debt obligations responsibly. Utilizing alternative credit histories is a positive step forward in engaging more low- and moderate-income consumers, and the practice should be awarded CRA credit.

COMMUNITY DEVELOPMENT:
Economic Development

Community development activities are considered under the regulations' large institution, intermediate small institution, and wholesale and limited purpose institution performance test. Small institutions may use community development activity to receive consideration toward an outstanding rating. CRA regulations define community development to include activities that promote economic development by financing businesses or farms that meet the size eligibility standards of the Small Business Administration's Development Company or Small Business Investment Company programs, or have gross annual revenues of $1 million or less.

Existing Guidance: Activities promote economic development by financing small businesses or farms if they meet both the (1) size and (2) purpose tests. Activities meet the purpose test if they currently support permanent job creation, retention, and/or improvement of low- and moderate-income individuals or geographies, or in areas targeted for redevelopment by federal, state, local, or tribal governments.

KEY CHANGES

The Agencies propose to:

- Clarify what is meant by "promote economic development" by removing the word "currently."

- Add additional examples of activities that support the purpose test including permanent job creation, retention, and/or improvement through:
  - Workforce development and/or job or career training programs that target unemployed or low- and moderate-income persons;
  - The creation or development of small businesses or farms; or
  - Technical assistance or supportive services for small businesses or farms, such as shared space, technology, or administrative assistance; and
  - Federal, state, local, or tribal economic development initiatives that include provisions for creating or improving access for low- and moderate-income persons to jobs, affordable housing, financial services, or community services.
- Include Community Development Financial Institutions (CDFIs) in the list of entities for which the Agencies will presume that any loan to or investment in promotes economic development.

ANALYSIS

The Agencies' stated goal is to clarify in the CRA Q&A that examiners should not be unnecessarily focused on bank community development activities that support low-wage jobs. The new list of items will certainly be helpful in expanding how examiners assess community development outcomes, and it is especially helpful to see that support for CDFIs is now specifically identified as a an activity that warrants CRA credit. The CRA Q&A could be even more helpful if there were specific language that instructed examiners to consider whether the outcomes of the community development activities actually align with a community's needs. For example, the purpose of this provision may be lost if there is a community in need of more low-wage jobs, but the area's financial institutions are still awarded credit because they support a large number of CDFIs that do not create low-wage jobs.

COMMUNITY DEVELOPMENT:
Community Development Loans

The Agencies' CRA regulations define "community development loan" to mean a loan that has community development as its primary purpose.

Existing guidance: Existing Q&A features a list of many examples of community development loans, including, among others, loans to borrowers for affordable housing rehabilitation and construction, loans to local, state, and tribal governments for community development activities, and loans to clean up industrial sites as part of revitalization efforts in low- and moderate-income communities.

KEY CHANGES

The Agencies propose to:

- Add loans related to "green" activities, including renewable energy or energy-efficient technologies that also have a community development component.

ANALYSIS

The inclusion of "green," energy-efficient technology in affordable housing projects should be encouraged. These technologies have the ability to reduce costs to entire complexes and grids over time and create a benefit for all. But as these technologies become mainstream and the cost of including them in housing development is on par with traditional systems, it is not clear that these projects need the additional incentive of CRA credit. CRA credit should be awarded when an institution supports the development of affordable housing, but additional CRA credit should not be extended to "green" activities, even those included in affordable housing developments, unless there is a direct, demonstrated benefit to low- and moderate-income residents.

COMMUNITY DEVELOPMENT:
Revitalize or Stabilize Underserved Nonmetropolitan Middle-Income Geographies

The Agencies' CRA regulations define community development activities that revitalize or stabilize particular areas.

Existing Guidance: The regulation states that activities revitalize or stabilize an underserved nonmetropolitan middle-income geography if they help meet essential community needs, including needs of low- and moderate-income individuals. Existing guidance lists examples of activities that have been shown to revitalize or stabilize communities, including a new hospital or industrial park that serves and employs low- and moderate-income residents, a new sewer line that serves low- and moderate-income residents, or a mixed-income housing development that includes affordable housing.

KEY CHANGES

The Agencies propose to:

- Revise the guidance by adding an example involving communication infrastructure as an activity that would be considered to "revitalize or stabilize an underserved nonmetropolitan middle-income geography."

ANALYSIS

The expansion of broadband infrastructure into rural and tribal areas will be important to making sure these areas remain connected and competitive, especially as more business, commerce, and job creation activities move online. The Agencies correctly note that broadband access in these areas remains limited. While broadband access is limited in some areas, it is not clear that broadband access is essential to a functioning community. More important, it is not clear that CRA is the appropriate vehicle to support its expansion.

The expansion of broadband infrastructure is inevitable because it is so crucial to the growing expansion of online business. The activities that warrant CRA credit have broadened over time, but the primary objective is still to incentivize financial institutions to help meet the needs of low- and moderate-income individuals and geographies. Broadband access is a growing need, especially in rural areas, and it is a clear priority for the Administration. But giving CRA credit for supporting broadband expansion is problematic. It is more important to use CRA credit to encourage financial institutions to find more direct ways to meet the needs of LMI individuals and geographies.

Finally, this section of the Q&A should be expanded to state that financial institutions that have demonstrated an unwillingness to support activities that are essential community needs should be penalized in their assessments. It is true that an essential need will be of equal benefit to high-income communities as it would be low- and moderate-income communities, but it is essential, and therefore the individual benefit should not need to be measured.

Proposed New Questions and Answers

The performance criteria for the large institution service test include (1) retail banking services, and (2) community development services. Examiners review both the availability and effectiveness of a financial institution's banking services and the extent and innovativeness of its community development services.

COMMUNITY DEVELOPMENT SERVICES:
Evaluating Retail Banking and Community Development Services

CRA regulations define a community development service as a service that (1) has as its primary purpose community development; (2) is related to the provision of financial services; and (3) has not been considered in the evaluation of the institution's retail banking services. The existing guidance lists some examples, including retail services, that benefit low- and moderate-income consumers. Examiners then evaluate community development services according to (1) the extent to which the institution provides community development services, and (2) the innovativeness and responsiveness of community development services.

NEW QUESTIONS

The Agencies propose to:

- Clarify how retail banking services are evaluated.
- Explain the importance of the community service criterion of the service test

New Q&A:
Q1: *How do examiners evaluate retail banking services and community development services under the large institution service test?*

A1: In evaluating retail services, examiners should consider the availability and effectiveness of an institution's systems to deliver banking services, particularly in low and moderate-income geographies and to low and moderate-income individuals, the range of services provided in low, moderate, middle, and upper-income geographies, and the degree to which the services are tailored to meet the needs of those geographies.

In evaluating community development services, examiners consider the extent of community development services offered, and the responsiveness and effectiveness of those retail services deemed community services under the existing Q&A because they improve or increase access to financial services by low and moderate-income individuals or in low or moderate-income geographies. Examiners will consider any information provided by the institution that demonstrates community development services are responsive to those needs.

ANALYSIS

The Agencies add some clarity to these standards by creating language that is roughly parallel for both retail and community development services. The new language also makes it clearer that it is not enough to have these services available; the services must also be effective in reaching low- and moderate-income individuals and geographies. The Agencies could, however, be even clearer in their efforts to address any uncertainty or confusion about these standards by stating explicitly in the guidance that both the retail and community development services should receive equal consideration.

COMMUNITY DEVELOPMENT SERVICES:
Quantitative and Qualitative Measures of Community Development Services

As stated above, the CRA regulations require the evaluation of (1) the extent to which an institution provides community development services, and (2) the innovativeness and responsiveness of community development services.

NEW QUESTIONS

The Agencies propose to:

- Include a new Q&A that would address the quantitative and qualitative factors that examiners review when evaluating community development services to determine if they are effective and responsive.

New Q&A:

Q2: *In evaluating community development services, what quantitative and qualitative factors do examiners review?*

A2: The community development services criteria are important factors in the evaluation of a large institution's service test performance. Both quantitative and qualitative aspects of community development services are considered during the evaluation. Examiners assess the extent to which community development services are offered and used. The review is not limited to a single quantitative factor, for example, the number of hours financial institution staff devotes to a particular community development service. Rather, the evaluation also assesses the degree to which community development services are responsive to community needs. Examiners will consider any relevant information provided by the institution and from third parties to quantify the extent and responsiveness of community development services.

ANALYSIS

The new question addresses important issues about how community development services are measured. It makes clear that it is insufficient to have community development services, and that those services must actually be responsive to community needs. This Q&A could be improved by requiring examiners to engage with community stakeholders outside of the financial institution to confirm that these services are actually reaching low- and moderate-income individuals and geographies.

RESPONSIVENESS AND INNOVATIVENESS:
Responsiveness

The Agencies' regulations and guidance provides that the greater an institution's responsiveness to credit and community development needs in its assessment area(s), the higher the CRA rating that is assigned to that institution.

Existing Guidance: Existing guidance on the definition and scope of "responsive" varies depending on the source.

KEY CHANGES:

The Agencies propose to:

- Revise the Q&A to make it clear that examiners will look not only at the volume and types of an institution's activities, but also at how effective those activities have been. The new language will include a non-exhaustive list of information sources that may inform this assessment, including:
  - Demographic and other information compiled by local, state, and federal entities;
  - Public comments received by the Agencies, for example, in response to the planned examination schedule;
  - Information from community leaders or organizations; and
  - The results of an assessment, prepared by an institution in the normal course of business, of the credit and community development needs in the institution's assessment area(s) and how the institution's activities respond to those needs.

ANALYSIS

The definition and scope of "responsive" in the context of CRA is of critical importance. These proposed amendments embrace the importance and accessibility of data, and the need for that data to demonstrate real results in an assessment area. We are also encouraged that the Agencies have specifically recognized the importance of including public comments and information from community organizations in their assessments. Public comments and information from community groups offer unique insight into the actual outcomes of a financial institution's activities. This standard could be strengthened, however, by requiring examiners to review information from all these sources, rather than identifying them as mere possibilities.

RESPONSIVENESS AND INNOVATIVENESS:
Innovativeness

Existing Guidance: Innovativeness is a standard found throughout the CRA regulations. The existing guidance on the definition and scope of innovativeness varies depending on the context and size of the institution being examined. In general, however, the use of innovative lending, investment, and development activities is not required for a "satisfactory" or "outstanding" rating. Innovative practices may augment the consideration given to an institution's performance under the quantitative criteria of the regulations, resulting in a higher level of performance rating.

KEY CHANGES

The Agencies propose to:

- Create new guidance that discusses innovativeness based on the institution. An innovative practice or activity will be considered when an institution implements meaningful improvements to products, services, or delivery systems that respond more effectively to customer and community needs.
- Describe innovativeness in terms of an institution's market and customers. For institutions that do not have the capacity to be market leaders in innovation, innovation includes the introduction of products, services, or delivery systems by institutions to their low- and moderate-income customers or segments of consumers or markets not previously served.
- Clarify that practices that cease to be innovative may still receive qualitative consideration for being flexible, complex, or responsive. A practice typically ceases to be innovative for an institution when the once-innovative practice has become a standard, everyday practice of the institution.

ANALYSIS

An institution's willingness and ability to innovate is critical to its survival in the changing financial services landscape. It is also critical to meeting the needs of underserved consumers when more traditional approaches and products have failed. With that in mind, CRA credit should not be awarded to innovative practices absent evidence that they are creating or improving access to financial services for low- and moderate-income individuals and geographies. The proposed guidance should emphasize that innovativeness is a good practice overall, but should instruct examiners to limit CRA credit to those innovations that have a demonstrated impact on low- and moderate-income individuals and geographies.

Appendix

The Agencies solicit comments on all aspects of this proposed revised Q&A. In addition, the Agencies specifically request commenters' views on the following questions:

Access to Banking Services

Availability and Effectiveness of Retail Banking Services

(1) Does the proposed revised guidance strike the appropriate balance between consideration of traditional delivery system (e.g., branches) and alternative systems for serving low and moderate-income geographies and individuals?

Alternative Systems for Delivering Retail Banking Services

(2) Are the factors listed for consideration sufficiently flexible to be used by examiners as the financial services marketplace evolves? Are there other factors that should be included?

(3) What types of information are financial institutions likely to routinely maintain that may be used to demonstrate that an institution's alternative delivery systems are available to, and used by, LMI individuals?

(4) What other sources of data and quantitative information could examiners use to evaluate the ease of access; cost to consumers, as compared with other delivery systems; range of services delivered; ease of use; rate of adoption; and reliability of alternative delivery systems? Do financial institutions have such data readily available for examiners to review?

(5) When considering cost to consumers, as compared with other delivery systems, and the range of services delivered, should examiners evaluate these features relative to other delivery systems offered by the institution, offered by institutions within the institutions assessment area(s), or offered by the banking industry generally?

(6) Do the proposed revisions adequately address changes in the way financial institutions deliver products in the context of assessment area(s) based on the location of a financial institution's branches and deposit-taking ATMs?

Innovative or Flexible Lending Practices

(7) Is the proposed revised guidance sufficient to encourage institutions to design more innovative or flexible lending programs that are responsive to community needs?

(8) Are the new examples described in the proposed revised guidance useful? Do the benefits of using alternative credit histories in underwriting standards that benefit low or moderate-income persons outweigh any concerns raised by the use of alternative credit histories of which the Agencies should be aware?

(9) Is there an additional guidance that the Agencies should provide to better enable examiners and institutions to identify those circumstances in which the use of alternative credit histories will benefit low or moderate-income individuals?

Community Development

Economic Development

(10) Does the proposed revised guidance clarify what economic development activities are considered under CRA?

(11) What information should examiners use to demonstrate that an activity meets the size and purpose tests described in the proposed revised guidance?

(12) Does the proposed revised guidance help to clarify what is meant by job creation for low or moderate income individuals?

(13) Are the proposed examples demonstrating that an activity promotes economic development for CRA purposes appropriate? Are there other examples the Agencies should include that would demonstrate that an activity promotes economic development for CRA purposes?

(14) What information should examiners review when determining the performance context of an institution seeking CRA consideration for its economic development activities?

(15) What information is available that could be used to evaluate the local business environment and economic development needs in a low or moderate income geography or among LMI individuals within the institution's assessment area(s)?

(16) Are there particular measurements of impact that examiners should consider when evaluating the quality of jobs created, retained, or improved?

Community Development Loans

(17) Should loans for renewable energy or energy-efficient equipment or projects that support the development, rehabilitation, improvement, or maintenance of community facilities that serve LMI individuals be considered under the CRA regulations?

(18) Do the proposed revisions make clear which energy efficiency activities would be considered under the CRA regulations?

Revitalize or Stabilize Underserved Nonmetropolitan Middle-Income Geographies

(19) Should communications infrastructure, such as broadband internet service, that serves as institution's community, including LMI residents, be considered an activity that revitalizes or stabilizes a community? Should CRA consideration be given to such activities?

(20) Does the proposed revised guidance sufficiently clarify which activities related to communications infrastructure would be considered under the CRA?

Proposed New Questions and Answers

Community Development Services

(21) Does the proposed new guidance sufficiently clarify how examiners evaluate retail and community development services under the large institution service test? If not, why not? How could the answer be made clearer?

(22) What types of information are financial institutions likely to maintain that may be used to demonstrate that an institution's community development services are responsive to the needs of low and moderate-income individuals and geographies?

Quantitative and Qualitative Measures of Community Development Services

(23) Does the proposed new guidance sufficiently explain the importance of the qualitative factors related to community development services?

(24) What types of information are financial institutions and relevant third parties likely to maintain that may be used to demonstrate the extent to which community development services are offered and used?

Responsiveness and Innovation

Responsiveness

(25) Does this new proposed guidance appropriately highlight the importance of responsiveness to credit and community development needs and provide a flexible, yet clear, standard for determining how financial institutions will receive consideration?

(26) Are there other sources of information that examiners should be consider when evaluating an institution's responsiveness to credit and community development needs?

(27) In connection with community development activities that will not directly benefit a financial institution's assessment area(s) as described in the 2013 Guidance, would the proposed new Q&A help a financial institution in making decisions about the community development activities in which to participate?

Innovation

(28) Does the proposed new guidance clarify what is meant by innovativeness?

(29) Does the proposed new guidance appropriately explain innovations that may occur at financial institutions of different sizes and types?

(30) Is it clear that innovative activities are not required?