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Agencies Release Proposed Questions and Answers Regarding Community Reinvestment Act

On September 10, 2014, the Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System ("Board"), and the Federal Deposit Insurance Corporation (FDIC) (collectively, the "agencies") released a joint proposal to revise their Interagency Questions and Answers Regarding Community Reinvestment ("Q&As") in order to address alternative delivery systems for banking services and the development of innovative and flexible lending practices, provide examples of activities and services considered to advance community development initiatives and provide general guidance to institutions on responsiveness and innovativeness. The agencies request comment on these proposals both generally and in response to specific questions before November 10, 2014.

Background

Congress enacted the Community Reinvestment Act (CRA) in 1977 to encourage financial institutions to help meet the credit needs of the local communities in which they are chartered. To carry out this purpose, the agencies implement the CRA through regulations applicable to the institutions under their supervision. The CRA regulations prescribe a series of performance tests—the lending test, investment test, service test and community development test—that are essentially the same for each agency and promulgated in mirrored sections of 12 CFR Parts 25, 195, 228 and 345. The agencies also provide further guidance in Q&As periodically published in the *Federal Register*.[1]

The agencies assign financial institutions CRA ratings based on their performance on the various tests. These ratings are then considered when the institutions submit applications to open new branches or engage in business combinations.

[1] The Q&As were last published in their entirety on March 11, 2010 (75 Fed. Reg. 11642), and were revised and amended by guidance published on November 20, 2013 (78 Fed. Reg. 69671).

Key Takeaways

- Under the proposed Q&As, brick and mortar branches are now less important in evaluating the effectiveness of retail banking services delivery, as institutions will now receive more CRA credit for alternative delivery systems such as online and mobile banking.
- Institutions should be able to receive community development CRA credit for some activities that indirectly result in job creation for low- and moderate-income (LMI) individuals and geographies, such as providing loans to community development financial institutions that finance small businesses or small farms.
- The proposed Q&As contain new examples of activities that advance community development initiatives, including financing the construction of broadband Internet infrastructure in underserved areas and providing loans for "green" projects that support the improvement or maintenance of affordable housing or community facilities.
- The agencies provide clarity on what "responsiveness" and "innovativeness" mean for the purposes of evaluations under the CRA regulations.

Summary of Proposed Changes

The proposed changes to the Q&As stemmed from comments provided to the agencies by bankers, community organizers and examiners following a 2010 invitation for input on ways to improve the CRA.[2] The agencies reviewed these comments and identified areas they believe warrant clarification or additional guidance.

Access to Banking Services Under the Service Test

The proposed Q&As include changes to two existing Q&As related to the "service test," which evaluates the availability and effectiveness of systems for delivering retail banking services according to certain criteria. Both of these revisions are aimed at giving institutions more CRA credit for alternative systems for delivering retail banking services.

Current Q&A § 24(d)-1 places examiners' "primary emphasis" on full service branch distribution and considers alternative delivery systems "only to the extent" that they are effective alternatives in providing services to LMI geographies and individuals. Commenters were concerned that this ignores advances in technology that have made alternative delivery systems a much more prominent component of retail banking and reduced the need for full service branches. Thus, the agencies propose revising Q&A § 24(d)-1 to delete the language placing a "primary emphasis on full service branches," along with the restrictive "only to the extent" language regarding alternative delivery systems. This change is meant to clarify that examiners should give more credit to banks for ensuring that alternative delivery systems are made available to LMI individuals and geographies.

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[2] The agencies held four hearings across the United States in 2010 and also invited and encouraged the submission of written comments. *See* 75 Fed. Reg. 35686 (June 23, 2010).

The agencies also seek to provide additional guidance for examiners in evaluating alternative delivery systems. Current Q&A § 24(d)(3)-1 provides a somewhat dated list of examples of alternative delivery systems, including ATMs, online banking and telephone banking. Commenters have expressed concern that this list is too restrictive and fails to account for the rapid development of new alternative delivery systems. Thus, the agencies propose to revise this Q&A to encourage examiners to consider a wider range of non-branch delivery systems, including "ATMs, online and mobile banking, and other means by which banks provide services to their customers [as they] evolve over time," and to state that "[n]o matter the means of delivery, examiners evaluate the extent to which the alternative delivery systems are available and effective in providing financial services to LMI geographies and individuals." The revised Q&A also provides examiners with a new list of factors to consider when assessing alternative delivery systems, including the ease of access, cost, ease of use, rate of adoption and reliability of the system.

Innovative or Flexible Lending Practices Under the Lending Test

An institution's use of innovative or flexible lending practices to address the credit needs of LMI individuals and geographies is one of five factors examiners review as part of the lending test. Current Q&A § 22(b)(5)-1 contains two examples of lending practices that the agencies deem to be innovative or flexible. The agencies propose expanding this list in a revised Q&A § 22(b)(5)-1 to include two new examples: small loan programs that are combined with outreach initiatives that include financial literacy or savings components; and lending practices that utilize alternative credit histories, such as rent and utility payments, in a manner that benefits LMI consumers. The revised Q&A would further emphasize that innovative and flexible lending practices are not required to achieve a specific rating, but are qualitative considerations that could potentially enhance a financial institution's CRA performance.

Community Development Under Various Performance Tests

Community development is a component of CRA performance tests for all institutions. The agencies propose to revise three Q&As related to community development.

The CRA regulations define community development to include activities that "promote economic development" by financing businesses or farms of certain sizes. Current Q&A § 12(g)(3)-1 further explains that activities "promote economic development" if they pass both a "size test" and a "purpose test" and states that activities meet the purpose test if they "support permanent job creation, retention, and/or improvement for persons who are currently low- or moderate-income." This definition of the purpose test led to some confusion about whether institutions could receive credit for activities that supported jobs that were not low-wage and made it difficult for institutions to receive credit for activities with microlenders and financial intermediaries that provide assistance to startup businesses. To eliminate this confusion and ensure that institutions receive CRA credit for activities that create jobs and aid small businesses and farms, the revised Q&A provides new examples of activities considered to promote economic development. Additionally, examiners would also now presume that loans to or investments in community development financial institutions that finance small businesses or small farms promote economic development.

Community development is also defined in the regulations to include activities that "revitalize or stabilize" particular areas. Current Q&A § 12(g)(4)(iii)-4 lists specific examples of activities that help to revitalize or

stabilize underserved nonmetropolitan middle-income areas. Citing the growing importance of consumer access to broadband Internet connections, the agencies propose to include as an example of a qualifying project a "new or rehabilitated communication infrastructure, such as broadband internet service, that serves the community, including low-and moderate-income residents."

The agencies also propose to revise a Q&A regarding community development loans. Community development loans are defined by the CRA regulations as a loan that has community development as its primary purpose and current Q&A § 12(h)-1 provides specific examples. Commenters have expressed concern that loans for "green" initiatives may not be receiving credit under the current guidelines, so the agencies propose to revise Q&A § 12(h)-1 to incorporate a new example of a community development loan that finances renewable energy or energy-efficient technologies that support the development, rehabilitation, improvement or maintenance of affordable housing or community facilities.

Community Development Services Under the Large Institution Service Test

The agencies propose to add two new Q&As regarding the community development service component of the service test for large institutions.

The performance criterion for the large institution service test includes retail banking services and community development services. Commenters have contended, however, that examiners have not given sufficient consideration to community development services. To remedy this problem, the agencies propose adding a new Q&A § 24(a)-1 that clarifies how community development services are evaluated and places equal emphasis on both retail services and community development services. The new Q&A specifically provides that examiners evaluate community development services by considering the extent of such services offered and their effectiveness.

The agencies also took notice of comments regarding the difficulty of qualitatively and quantitatively evaluating community development services for the service test. Of particular concern were comments indicating that institutions and evaluators tend to focus on singular quantitative factors that do not necessarily reflect the effectiveness and responsiveness of the services. Thus, the agencies propose a new Q&A § 24(e)-2 that addresses the quantitative and qualitative factors examiners review when evaluating community development services. The new Q&A states that both quantitative and qualitative aspects are considered, and the examiners will specifically assess the extent to which the community development services are offered and used and the degree to which community development services are responsive to community needs.

Clarifications on "Responsiveness" and "Innovativeness"

The term "responsiveness" is used throughout the CRA regulations in regard to the various performance tests. To clarify what it means for an institution to be "responsive" to credit and community development needs, the agencies propose a new Q&A § 21(a)-3. The new Q&A states that examiners should first evaluate the volume and type of an institution's activities, then consider the qualitative aspects of its performance of those activities, including their effectiveness. Activities should be considered particularly responsive to community needs if they benefit LMI individuals or geographies, designated disaster areas, or distressed or underserved nonmetropolitan middle-income geographies.

"Innovativeness" is also a term used throughout the performance tests. The agencies seek to clarify "innovativeness" with a new Q&A § 21(a)-4. The new Q&A provides that new services or products are innovative when they respond more effectively to consumer and community needs. The new Q&A further clarifies that institutions that do not have the capacity to be market leaders in innovation can demonstrate innovativeness by introducing existing types of products, services or delivery systems to LMI customers or segments not previously served and also provides that practices that cease to be innovative may still receive consideration for being flexible, complex or responsive.

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Clifford S. Stanford
404.881.7833
cliff.stanford@alston.com

Will Hooper
404.881.4697
will.hooper@alston.com

ALSTON & BIRD LLP

WWW.ALSTON.COM

ATLANTA: One Atlantic Center ▪ 1201 West Peachtree Street ▪ Atlanta, Georgia, USA, 30309-3424 ▪ 404.881.7000 ▪ Fax: 404.881.7777
BRUSSELS: Level 20 Bastion Tower ▪ Place du Champ de Mars ▪ B-1050 Brussels, BE ▪ +32 2 550 3700 ▪ Fax: +32 2 550 3719
CHARLOTTE: Bank of America Plaza ▪ 101 South Tryon Street ▪ Suite 4000 ▪ Charlotte, North Carolina, USA, 28280-4000 ▪ 704.444.1000 ▪ Fax: 704.444.1111
DALLAS: 2828 North Harwood Street ▪ 18th Floor ▪ Dallas, Texas, USA, 75201 ▪ 214.922.3400 ▪ Fax: 214.922.3899
LOS ANGELES: 333 South Hope Street ▪ 16th Floor ▪ Los Angeles, California, USA, 90071-3004 ▪ 213.576.1000 ▪ Fax: 213.576.1100
NEW YORK: 90 Park Avenue ▪ 15th Floor ▪ New York, New York, USA, 10016-1387 ▪ 212.210.9400 ▪ Fax: 212.210.9444
RESEARCH TRIANGLE: 4721 Emperor Blvd. ▪ Suite 400 ▪ Durham, North Carolina, USA, 27703-85802 ▪ 919.862.2200 ▪ Fax: 919.862.2260
SILICON VALLEY: 1950 University Avenue ▪ 5th Floor ▪ East Palo Alto, California, USA, 94303-2282 ▪ 650.838.2000 ▪ Fax: 650.838.2001
WASHINGTON, DC: The Atlantic Building ▪ 950 F Street, NW ▪ Washington, DC, USA, 20004-1404 ▪ 202.756.3300 ▪ Fax: 202.756.3333