CAPCO

COMMUNITY REINVESTMENT ACT (CRA) MODERNIZATION

LARGE BANK IMPACT

CONTENT

1. INTRODUCTION

On May 5, 2022, the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), and the Federal Reserve Board (FRB) issued a joint Notice of Proposed Rulemaking (NPR) on the Community Reinvestment Act (CRA). The nearly 700-page NPR is intended to strengthen and modernize the rule that implements the CRA. The comment period closed on August 5, 2022. The last significant interagency revision to the CRA regulations occurred in 1995.

While banks have strongly supported the modernization of the CRA, the American Bankers Association (ABA) and 51 bankers' associations have asked the Agencies to consider extending the 90-day comment period and the 12-month implementation period. Nonetheless, the Agencies are likely to aggressively continue to finalize the rulemaking, including the 12-month implementation period, given concerns by the Biden Administration that under the Congressional Review Act, a Republican Congress and administration in 2025 could disapprove a delayed final rule and require the Agencies to reissue a new rule. Accordingly, banks are encouraged to thoroughly review the NPR and start planning for implementation, paying particular attention to the additional data collection, analysis, and reporting requirements. Also, a bank's CRA performance will remain a critical factor for evaluating applications for mergers, acquisitions, and new branches.

The proposed rule brings about significant changes to the way CRA performance would be evaluated in the future. While the proposed changes increase transparency and clarity around requirements, they pose challenges, particularly for large banks – those with assets of $2 billion or greater. One of the most significant changes for large banks is the requirement to create retail lending assessment areas (RLAAs) beyond facility-based assessment areas (FBAAs), where the bank has originated at least 100 home mortgage loans or 250 small business loans in any Metropolitan Statistical Area (MSA) or the combined non-MSAs in a state for two consecutive years. This could significantly increase the number of assessment areas in which a large bank's performance will be evaluated.

Based on performance within all their assessment areas (RLAAs and FBAAs), large banks, including those evaluated under a strategic plan, would receive state, multistate MSA, and overall institution ratings based on performance across four tests:

- Retail Lending Test (45% weight)
- Retail Services and Products Test (15% weight)
- Community Development (CD) Financing Test (30% weight)
- Community Development (CD) Services Test (10% weight)

1.1. Retail Lending Test

The new Retail Lending Test would compare the bank's performance to market-based benchmarks, including a volume screen (for FBAAs), as well as geographic and borrower distributions (for FBAAs and RLAAs).

For each FBAA, the volume screen would compare the bank's ratio of its retail lending originations and its deposits to the aggregate ratio of all other large banks operating in the same FBAA. Failure to achieve at least 30% of the aggregate benchmark could limit the bank's potential rating for that FBAA to "Needs to Improve" or "Substantial Noncompliance" depending on the geographic and borrower distribution metrics (based on number of loans) of its major product lines, as well as consideration of the bank's performance context. Banks that meet or exceed 30% of the aggregate benchmark would be eligible for "Outstanding" or "Satisfactory" ratings for that FBAA, again, depending on the geographic and borrower distribution metrics (based on number of loans) of its major product lines, as well as consideration of the bank's performance context.

Major product lines are those that are 15% of the total dollar volume of all retail lending within each assessment area (FBAAs and RLAAs) and may include:

- closed-end mortgages
- open-end home mortgages
- multifamily loans
- small business loans (defined using current standard until Section 1071 is implemented)
- small farm loans (defined using current standard until Section 1071 is implemented)
- auto loans (if also 15% of the total number of loans)

In addition to performance within each FBAA, the Retail Lending Test would also consider performance in each RLAA based on the geographic and borrower distribution metrics (based on number of loans) of its major product lines, among other performance context factors in each RLAA.

The ultimate ratings for each assessment area will be derived from a rating chart based on prescribed percentages for each rating level applied to the aggregate lending volumes. As a result, ratings should be less subjective and more transparent than they are today.

1.2. Retail Services and Products Test

Under the Retail Services and Products Test, large banks would be evaluated on how well their credit and deposit products, as well as the availability of their branches and remote service facilities, digital, and other delivery systems, meet low- and moderate-income (LMI) community needs of affordability and responsiveness.

1.3. Community Development Financing Test

The new CD Financing Test includes both loans and investments and enables banks to attribute those outside of FBAAs to a specific rated area. A CD Financing Metric would measure the dollar amount of a bank's CD loans and investments in, or attributed to, a rated area relative to the dollar amount of the bank's deposits in the rated area. Benchmarks would be established using local area context and the evaluation would include a qualitative impact review.

1.4. Community Development Services Test

The CD Services Test would evaluate the extent of community development services provided by a large bank and the impact and responsiveness of these activities. Large Banks with assets over $10 billion would be required to collect, maintain, and report CD service information. This data would be subject to a quantitative review using the standardized metric of CD service hours per full-time employee.

2. WHAT SHOULD LARGE BANKS BE DOING NOW TO PREPARE?

Clearly these are significant changes. Banks should plan on additional support for their CRA program and should start analyzing how they might fare against the new metrics based on available information. Changes to a bank's current CRA performance strategy may be required to achieve at least a satisfactory rating given the new thresholds, new tests, and defined metrics, particularly with respect to the Retail Lending Test. In addition to closely monitoring the status of the NPR, Capco recommends the following actions as best practices to evaluate systems and automation:

2.1.1. General

- Evaluate if and how current loan systems can be used for applicable data collection, analysis, and reporting
- Determine if additional systems or automation are required to achieve and maintain compliance
- Prepare staffing plan to address potential resources needs

2.1.2. Retail Lending Test

- Identify all FBAAs and potential RLAAs, using full counties
- Identify major products lines in each Assessment Area (AA)
- Identify source documents/data for all new reporting requirements across all retail product lines, considering
    - Impact of Section 1071 on small business and small farm loans
    - If the Bank currently includes open-end mortgages on its HMDA-LAR

2.1.3. Retail Products and Services Test

Determine source and availability of information related to:

- Branches and remote service facilities
- Retail services and products offered and provided
- Range of services and products offered through digital and other delivery systems
- Digital activity by individuals by census tract category
- Data on responsive deposit products

2.1.4. CD Financing Test

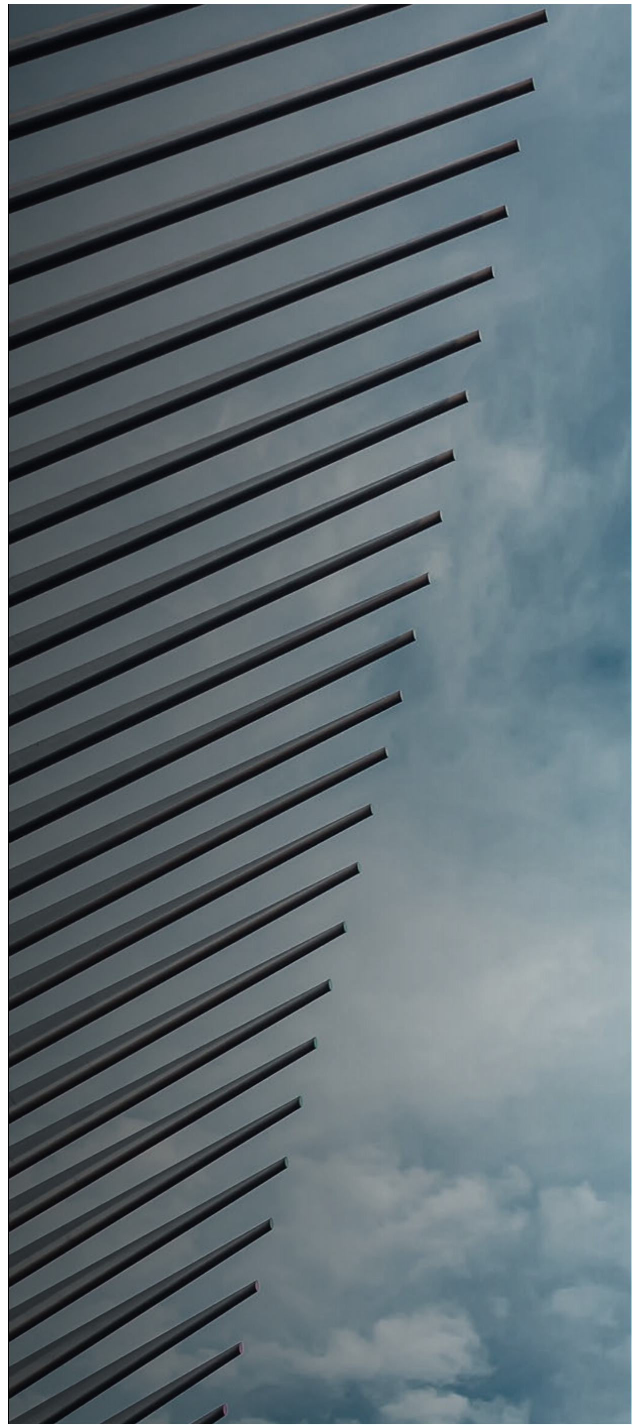
Compare current data collection processes to new expectations and prepare plan to comply, including line-item data for all CD loans and investments originated or purchased during the current or prior evaluation period

2.1.5. CD Services Test

Compare current data collection processes to new expectations and prepare plan to comply, including service hours per full time employee

2.1.6. Deposits

- Determine source and availability of the dollar volume of deposits at the county level, based upon the address associated with the individual account
- Review the implementation plan for FDIC 370 for potential overlap and reuse with CRA deposit data collection requirements and existing solutions or anticipated enhancements



3. FINAL OBSERVATION

Technology support will be critical to the efficient and effective implementation of the new rule; however, technology teams may be strained by the aggressive 12-month implementation period, as well as other new data collection and reporting requirements, including the Consumer Financial Protection Bureau's (CFPB's) expected final rule for small business lending data collection (Section 1071 of the Dodd-Frank Act) and open banking (Section 1033 of the Dodd-Frank Act).

Even though the rule is still being finalized, there is value in planning and acting on anticipated needs with initial efforts in data collection and governance to get a step ahead. Initiatives such as documenting data lineage, data mapping, KPI requirements, establishing the approach for the technical architecture for data aggregation and reporting will all have value as foundational steps to accelerate the response to the finalized rule. These efforts may also align to existing data governance initiatives and artifacts that can be reused for other reporting and data management activities.

Banks should have a plan in place, but delay implementation until the rule is finalized. Banks that initiate system and compliance changes prior to the issuance of a final rule run the risk of having to backtrack if the final rule is different from the current proposal. These concerns and others were expressed in a Statement for the Record of the American Bankers Association Before the Subcommittee on Consumer Protection and Financial Institutions of the U.S. House Financial Services Committee, July 13, 2022, and in the Joint ABA and State Bankers Association Letter to the Agencies on the Proposed CRA Overhaul, August 5, 2022.

AUTHORS

Peter Dugas, Executive Director
Elizabeth Rozsa, Senior Consultant
Elanna Kooistra, Principal Consultant

CONTACT

Bob Cardwell, Managing Principal, robert.cardwell@capco.com

ABOUT CAPCO

Capco, a Wipro company, is a global technology and management consultancy focused in the financial services industry. Capco operates at the intersection of business and technology by combining innovative thinking with unrivalled industry knowledge to fast-track digital initiatives for banking and payments, capital markets, wealth and asset management, insurance, and the energy sector. Capco's cutting-edge ingenuity is brought to life through its award-winning Be Yourself At Work culture and diverse talent.

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