

The Community Reinvestment Act: The 2005 Joint Ruling in Perspective

The Community Reinvestment Act: *The Next Chapter*

On July 19, 2005, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency approved final changes to their Community Reinvestment Act regulations. The joint rule takes effect on September 1, 2005.¹

Since 1977, the Community Reinvestment Act has mandated that most FDIC-insured institutions help meet the credit needs of the communities they serve, including low-and moderate-income neighborhoods, without compromising safety and soundness. While the goal of the CRA remains unchanged, the updated regulations encourage development in additional communities, including distressed or underserved middle-income rural areas and regions affected by natural disasters. For the complete regulation, please refer to the Joint Final Rule, available at: www.federalreserve.gov.

Changes to the Definition of a Small Bank

Under the rule change, a small bank is defined as a bank that, as of December 31 of either of the two prior calendar years, had assets of less than \$1 billion. The new rule also creates an additional size category of “intermediate small bank,” defined as a bank that had assets of at least \$250 million and less than \$1 billion as of December 31 of either of the two prior calendar years. The asset amount used to determine a bank’s CRA classification will be adjusted annually for inflation based on changes in the Consumer Price Index.²

The new rule differs from the previous one, which defined a large bank as a bank with assets exceeding \$250 million or a bank that was part of a holding company with assets of \$1 billion or more.

In summary, the new CRA rule amends the definition of a small bank, introduces an “intermediate small bank” category with unique CRA requirements, and maintains the large bank three-pronged test. The new rule does not consider the size of a bank’s holding company.

1. On October 1, 2004 and April 1, 2005, the Office of Thrift Supervision revised its CRA rules to expand the category of “small savings associations” to institutions with under \$1 billion in assets, regardless of holding company affiliation, and to allow a large savings association to determine the weight that will be assigned to lending, investments, and service activities in its CRA evaluation provided that lending activities receive a weight of at least 50 percent.

2. Annual adjustments will be based on the year-to-year change in the average of the Consumer Price Index for Urban Wage Earners and Clerical Workers, not seasonally adjusted, for each twelve-month period ending in November, with rounding to the nearest million.

Intermediate Small Bank Test

An intermediate small bank will be subject to a community development test as well as the small bank lending test. Examiners will use the following criteria to determine an intermediate small bank's community development rating:

- (1) The number and amount of community development loans;
- (2) The number and amount of qualified investments;
- (3) The extent to which the bank provides community development services; and
- (4) The bank's responsiveness to community development lending, investment, and service needs.

Community development activities will be evaluated in the context of a bank's specific capacities, local community needs, and available opportunities. The agencies anticipate that the new, expanded definition of community development will allow "a bank to apply its resources strategically to the types of community development activities (loans, investments, and services) that are most responsive to helping to meet community needs,"³ without precluding or ignoring any category of community development.

While "innovativeness" and "complexity" remain factors for large bank exams, they are not part of the intermediate small bank community development test. Rather, examiners will look at a bank's responsiveness to community development needs when determining its overall community development test rating.

Intermediate Small Bank Ratings

Under the new rule, an intermediate small bank would not be eligible for an overall rating of "satisfactory" unless it received ratings of "satisfactory" on both the lending and community development tests. An intermediate small bank that receives an "outstanding" rating on one test and at least a "satisfactory" on the other may receive an overall rating of "outstanding."

"Community Development" Definition Revisions

The revised definition of community development stems from the agencies' desire to ensure that community development activities in underserved middle-income rural areas and state and federally

3. Community Reinvestment Act Regulations, Joint Final Rule dated July 19, 2005

designated disaster areas are eligible for CRA credit. Previously, the definition of community development was limited to affordable housing and services provided for low- or moderate-income individuals and other activities that revitalized or stabilized low- or moderate-income areas.⁴

The new rule amends the definition of community development to include activities that revitalize or stabilize designated disaster areas and rural, middle-income geographies that the agencies have designated as distressed or underserved.⁵ An area may be designated based on criteria indicating it is distressed (poverty rate, unemployment rate, and population loss) or indicating that it is likely to have difficulty financing the fixed costs of meeting essential community needs (population size, density, and dispersion).

The affordable housing component of community development has been modified slightly to specify that an activity which primarily provides affordable housing to low- or moderate-income individuals may receive additional weight in the evaluation process if the examiner determines that the initiative also helps revitalize or stabilize a low- or moderate-income census tract, a distressed or underserved rural area, or a designated disaster area.⁶

In addition, housing that is not intended for low- or moderate-income individuals but that helps revitalize or stabilize an eligible rural area may qualify as a community development activity.

Evidence of Discriminatory or Other Illegal Credit Practices

Evidence of discrimination or other illegal credit practices by a bank or its affiliate in geographies that are considered in the CRA evaluation will negatively affect CRA performance.

4. Federal Financial Institutions Examination Council Community Reinvestment Act; Interagency Questions and Answers Regarding Community Reinvestment, Federal Register, July 12, 2001, §§ _____.12(h)-563e.12(g) Community Development, page 36,625.

5. A list of eligible rural tracts that are distressed or underserved will be available at www.ffiec.gov.

6. Community Reinvestment Act Regulations, Joint Final Rule. Draft dated July 19, 2005.

Conclusion

The updated rule should reduce regulatory burden and provide banks with further options to serve the most important economic needs of their local communities. The agencies have indicated that they “do not intend to suggest that a bank may simply ignore one or more categories of community development or arbitrarily decrease the level of such activities.” Instead, they “expect that a bank will appropriately assess the needs in its community, engage in different types of community development activities based on those needs and the bank’s capacities, and that it will take reasonable steps to apply its community development resources strategically to meet those needs.”⁷

In amending the regulation, the agencies stressed the importance of banks’ responsiveness to their unique, local economic development needs. Communities that have undergone economic downturns due to job loss or population shifts, federal and state disaster areas, and rural areas should benefit from an infusion of community development capital from local banks. Perhaps most importantly, the rule addresses the nation’s evolving community development needs while allowing banks the flexibility to make strategic community development decisions based on those needs.

Barbara Rose VanScoy
Managing Director

For more information, contact Community Capital Management at www.ccmfixedincome.com or (877) 212-1977.

⁷ *Id.*