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Section 1071 Final Rule and the Proposed CRA Rule – Operational Issues and Interplay

Speakers:

- Michael Flynn, Buchalter
Mflynn@buchalter.com
- Joel N. Cook, Aldrich & Bonnefin
JCook@ABLawyers.com

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CFPB's New Small Business Lending Data Collection Rule



Background

- Dodd-Frank Act Section 1071
 - Requires covered lenders to compile and report information regarding covered credit applications made by small businesses, including women-owned and minority-owned small businesses
 - The stated purpose of Section 1071:

“to facilitate enforcement of **fair lending laws** and enable communities, governmental entities, and creditors to identify business and community development needs and opportunities of women-owned, minority-owned, and small businesses”



Background

- New Final Rule
 - Issued on March 30, 2023, published in the Federal Register on May 31, 2023
 - Amends Regulation B to implement changes to ECOA made by Section 1071 (the “Final Rule”)



Overall Impact on Institutions

- Fair lending issues will become more visible



- Reputation and impact on businesses
- Data collection efforts will need to be undertaken

Overall Impact on Institutions

- Formalizing application process
- Resources will need to be expended, such as with respect to developing policies and procedures, updating systems, and training staff



What is Your Compliance Date?

- Imposes tiered compliance dates which correspond to how many covered credit transactions a financial institution originated in each of the preceding two calendar years, starting with 2022 and 2023
- Compliance dates
 - October 1, 2024: originated at least 2,500 covered credit transactions in 2022 and 2023
 - April 1, 2025: originated at least 500 covered credit transactions (but less than 2,500) in 2022 and 2023
 - January 1, 2026: originated at least 100 covered credit transactions in 2022 and 2023



What is Your Compliance Date?

- But wait, how about *Texas Bankers Ass'n v. CFPB* (No. 7:23-CV-00144, July 31, 2023)?
- On July 31, 2023, the U.S. District Court for the Southern District of Texas granted a preliminary injunction which prevents the CFPB from implementing or enforcing the Final Rule against the plaintiffs and their members



What is Your Compliance Date?

- **IMPORTANT**: The Texas court's injunction only applies to Rio Bank and other lenders that are members of the Texas Bankers Association or American Bankers Association
 - Means that the Final Rule's compliance dates are still applicable to lenders that are not members of the ABA or TBA (unless they are Rio Bank)



What is Your Compliance Date?

- The District Court's injunction is temporary
- Injunction is effective until the U.S. Supreme Court reaches a final decision in *Cmty. Fin. Servs. Ass'n of Am., Ltd. v. CFPB* (5th Cir. 2022)
 - There, a group of plaintiffs sued the CFPB in 2018 attempting to have the court vacate the CFPB's Payday Lending Rule on the grounds that the CFPB's funding structure was unconstitutional
 - U.S. Supreme Court's decision on the *Cmty. Fin. Servs. Ass'n of Am.* case is expected during the first half of 2024
 - If the U.S. Supreme Court reverses the lower court's decision in *Cmty. Fin. Servs. Ass'n of Am.*, then the CFPB must extend the Final Rule's compliance dates to compensate for the stay of the enforcement per the injunction



What is Your Compliance Date?

- In May 2023, a resolution was introduced in the U.S. House of Rep. to completely overturn the Final Rule (H.J. Res. 66)
 - Latest update (as of 8/24/23) – resolution was approved by the House's Financial Services Committee on July 31, 2023
 - The House and Senate have not yet voted on the resolution



What Institutions are Covered?

- “Covered financial institution” means a financial institution that originated at least 100 “covered credit transactions” for “small businesses” in each of the two preceding calendar years
- **NOTE:** Banks, savings associations, and credit unions (among others) may qualify as covered financial institutions if the threshold is met



What Credit Transactions are Covered?

- “Covered credit transaction” as an extension of business credit (*unless the transaction is one of the “excluded” transactions*)
 - This includes all business credit, including loans, lines of credit, credit cards, and merchant cash advances unless otherwise excluded



How is Small Business Defined?

- A business is a “small business” if it meets the SBA’s definition of certain similar terms
 - However, the Final Rule looks to whether the business had \$5 million or less in gross annual revenues in its preceding fiscal year



What Information Must be Collected?

- Must collect the following information with regard to applications for “covered credit transactions” made by “small businesses”:
 - Unique identifier of the lender
 - Application date
 - Application method
 - Application recipient
 - Credit type
 - Credit purpose
 - Amount applied for
 - Amount approved or originated
 - Action taken & the date



What Information Must be Collected?

- Must collect the following information with regard to covered applications (cont'd):
 - Denial reasons
 - Pricing information
 - Census track
 - Gross annual revenue
 - NAICS code or information about the business such that the financial institution can collect the NAICS code
 - Number of workers
 - Time in business
 - **Minority-owned** business status
 - **Women-owned**, and **LGBTQI+-owned** business status
 - Number of principal owners and their: **ethnicity**, **race** and **sex**

What is a Women-, Minority-, or LGBTQI+-owned Business?

- Both of the following must occur with regard to the women owners, minority owners or LGBTQI+ owners:
 - One or more own or control more than 50 percent of the business (*for example, 2 owners identify as LGBTQI+ and together they own 66% of the business*); **and**
 - More than 50 percent of its net profits or losses accrue to one or more (*for example, 66% of the profits accrue (in the aggregate) to the 2 owners who identify as LGBTQI+*)



Who are Principal Owners?

- A “principal owner” is an individual who directly owns 25 percent or more of the equity interests of a business
- Only direct ownership, not indirect
- Need to request information about the ethnicity, race and sex of the principal owners



CFPB's Model Form

- The CFPB has provided a model “data collection form” to collect information about:
 - Minority, women-owned and LGBTQI+-owned business status
 - Principal owners and demographic information about those owners



Miscellaneous Issues

- Firewall requirements
- Must annually report the data points collected under the Final Rule to the CFPB
- Must keep specified records for at least three years after submission to the CFPB



What Should You Do Next?

- Determine whether your institution qualifies as a “covered financial institution” under the Final Rule
 - Begin analyzing small business lending data from 2022 and 2023
- Determine if your institution is covered by the District Court’s injunction in *Texas Bankers Ass’n v. CFPB*
- May want to form a committee to begin strategizing how best to comply with the Final Rule



What Should You Do Next?

- To help avoid potential fair lending issues, take a hard look at small business lending before the mandatory compliance date
- Update policies and procedures before the applicable compliance date to comply with the Final Rule
- Train commercial loan officers and others on the commercial lending team to ensure the institution can comply with the Final Rule
- Consider using written commercial loan applications that incorporate the questions and disclosures required by the Final Rule, such as by using the written Model Collection Form



The Proposed Community Reinvestment Act Rule and How It Would Affect Your Business

New Bank Definitions

- Large banks would be banks that had average quarterly assets, computed annually, of at least \$2 billion in both of the prior two calendar years;
 - Certain provisions of the Retail Services and Products Test and Community Development Services Test would apply only to large banks that had average quarterly assets, computed annually, of over \$10 billion in both of the prior two calendar years
- Intermediate banks would be banks that had average quarterly assets, computed annually, of at least \$600 million in both of the prior two calendar years and less than \$2 billion in either of the prior two calendar years; and
- Small banks would be banks that had average quarterly assets, computed annually, of less than \$600 million in either of the two prior calendar years

Tests Different Categories of Banks **Will Be Measured By**

Large banks

- Retail Lending Test
- Retail Services and Products Test
- Community Development Financing Test, and
- Community Development Services Test

Intermediate banks

- Retail Lending Test and the status quo community development test, unless they choose to opt into the Community Development Financing Test

Small banks

- Status quo small bank lending test
 - Unless they choose to opt into the Retail Lending Test

Wholesale and limited purpose banks

- A tailored version of the Community Development Financing Test

Assessment Areas and Areas for Eligible Community Development Activity

- **Facilities-Based Assessment Areas**
 - Banks must delineate facility-based assessment areas for main offices, branches, and deposit-taking remote service facilities (to include ATMs)
 - Under the proposal, large banks would delineate assessment areas comprised of full counties, metropolitan divisions, or MSAs
 - Intermediate and small banks could continue to delineate partial county facility-based assessment areas, consistent with current practice
- **Non-Facilities Based Assessment Areas**
 - Large banks would have to delineate retail lending assessment areas where the bank has an annual lending volume of at least 100 home mortgage loan originations or at least 250 small business loan originations in an MSA or nonmetropolitan area of a state for two consecutive years
- The proposal also allows banks to receive CRA credit for any qualified community development activity, regardless of location, although performance within facility-based assessment areas would be emphasized

Facility-Based Assessment Areas and Retail Lending Assessment Areas – Large and Intermediate Banks

Agencies would use a retail lending volume screen to evaluate a bank's retail lending volumes

- Evaluating a bank's major product lines using two distribution metrics that measure the bank's record of lending
 - in low-and moderate-income census tracts and
 - to borrowers of different income or revenue levels

KEY: There would be a standardized methodology for setting performance expectations for specific product lines

- The methodology defines performance ranges for each conclusion category for each product
 - This performance is then averaged together
 - The amount of lending needed to achieve a given conclusion would differ across assessment areas according to local credit demand and would calibrate across business cycles

More Detailed Creation of Performance Scores - More Objective Scoring, Less Subjective Consideration

- Performance scores for each applicable test based on a weighted average of assessment area conclusions, at the
 - State
 - Multistate
 - MSA, and
 - Institution levels
 - Also consideration of additional test-specific factors at the state, multistate MSA, or institution level
- Scores are:
 - Mapped to conclusion categories to provide test-specific conclusions for the state, multistate MSA, and at the institution level
 - Combined across tests to produce ratings at the state, multistate MSA, and the institution level

Determining When a Bank's Retail Lending Product Lines Are Evaluated Under the Retail Lending Test

- The following retail lending product line categories are proposed:
 - Closed-end home mortgage
 - Open-end home mortgage
 - Multifamily
 - Small business (\$5 million or less annual revenue)
 - Small farm lending
 - Automobile lending
- The agencies propose a major product line standard to determine when a retail lending product line is evaluated

Retail Lending Test Conclusions in State, Multistate MSAs, and at the Institution Level – Large and Intermediate Banks

Large and Intermediate banks will be assigned conclusions on the Retail Lending Test

- At the state and multistate MSA levels
 - Based on the conclusions reached at individual facility-based and retail lending assessment areas, as applicable
- At the institution level by combining conclusions from all of a bank's
 - Facility-based and retail lending assessment areas, as applicable, and
 - Retail lending performance outside of the bank's assessment areas
 - This recognizes that some bank lending may be geographically diffuse, without concentrations in particular local markets that would be captured by the proposed retail lending assessment areas

Retail Lending Performance Standards for Small and Intermediate Banks

Small Banks - continue to evaluate under the current small bank performance standards

- Small banks could opt into the Retail Lending Test and could continue to request additional consideration for other qualifying CRA activities

Intermediate Banks - apply the proposed metrics-based Retail Lending Test

- Also evaluate an intermediate bank's community development activity pursuant to the criteria under the current intermediate small bank community development test
- Intermediate banks could also opt to be evaluated under the proposed Community Development Financing Test

Evaluating Large Banks Under the Retail Services and Products Test

- Predominantly qualitative approach, incorporating quantitative measures as guidelines, as applicable
 - Delivery systems part of the proposed test considers a bank's
 - branch availability and services
 - remote service facility availability, and
 - for large banks with assets of over \$10 billion in assets
 - Its digital and other delivery systems
 - Its efforts to offer products that are responsive to the needs of low- and moderate-income communities

Impact Review of Community Development Activities

The agencies propose specific impact review factors to inform the evaluation of a bank's activities under the Community Development Financing Test, the Community Development Services Test, and the Community Development Financing Test for Wholesale or Limited Purpose Banks

Proposed Rule's Community Development Definitions

- Affordable housing; economic development that supports small businesses and small farms; community supportive services; revitalization activities; essential community facilities; essential community infrastructure; recovery activities in designated disaster areas; disaster preparedness and climate resiliency activities; activities with minority depository institutions (MDIs), women's depository-institutions (WDIs), low income credit unions (LICUs), and Community Development Financial Institutions (CDFIs) certified by the U.S. Department of the Treasury (Treasury Department), referred to as Treasury Department-certified CDFIs; financial literacy; and qualifying activities in Native Land Areas. The agencies propose using a primary purpose standard for determining eligibility of the above activities, with pro rata consideration for certain affordable housing activities.

Community Development Financing Test

Applies to large banks (as well as intermediate banks that choose to opt into this test)

- Consists of a community development financing metric, benchmarks, and an impact review
- These components would be assessed at the
 - Facility-based assessment area
 - State
 - Multistate
 - MSA
 - Institution levels
 - Would inform conclusions at each of those levels

Community Development Services Test

The proposed test would consist of a primarily qualitative assessment of the bank's community development service activities

- For large banks with assets of over \$10 billion, the agencies propose also using a metric to measure the hours of community development services activity per full time employee

In nonmetropolitan areas, banks may receive community development services consideration for volunteer activities that meet an identified community development need, even if unrelated to the provision of financial services

Wholesale and Limited Purpose Banks' Community Development Financing Test

Includes:

- a qualitative review of a bank's community development lending and investments in each assessment area
- an institution level-metric measuring a bank's volume of activities relative to its capacity

These banks would also have the option to have examiners consider community development service activities that would qualify under the Community Development Services Test.

Determine a Large or Intermediate Bank's Overall State, Multistate, MSA, or Institution Rating

Taking a weighted average of the applicable performance test scores

- For large banks the agencies propose the following weights: 45 percent for Retail Lending Test performance score; 15 percent for Retail Services and Products Test performance score; 30 percent for Community Development Financing Test performance score; and 10 percent for Community Development Services Test performance score
- For intermediate banks, the agencies propose to weight the Retail Lending Test at 50 percent and the Community Development Test, or if the bank chooses to opt into the Community Development Financing Test, at 50 percent

Strategic Plans as an Alternative Method for Evaluation

- Banks would continue to request approval for the plan from their appropriate Federal banking agency
- There would be more specific criteria to ensure that all banks are meeting their CRA obligation to serve low-and moderate-income individuals and communities
- Banks would have the same assessment area requirements as other banks and would submit plans that include the same performance tests and standards that would otherwise apply unless the bank is substantially engaged in activities outside the scope of these tests
 - In seeking approval for a plan that does not adhere to requirements and standards that are applied to other banks, the plan would be required to include an explanation of why the bank's view is that different standards would be more appropriate in meeting the credit needs of its communities

In addition to currently collected data:

- Large Banks must collect, maintain, and report additional data
 - All large banks would have the same requirements for certain categories of data, including community development financing data, branch location data, and remote service facility location data
 - Large banks with assets of over \$10 billion would have data requirements for deposits data, automobile lending data, retail services data on digital delivery systems, retail services data on responsive deposit products, and community development services data
 - Updated standards for all large banks to report the delineation of their assessment areas
- Data requirements for intermediate banks and small banks would remain the same as the current requirements

Transition

Generally, the final rule takes effect on the first day of the first calendar quarter following 60 days after publication of the final rule

The CFPB will begin examining for CRA compliance two years after the publication date of the final rule

Overall Impact of Proposed Rule

- More tests and criteria evaluated, especially for large banks
- More objective scoring
- Potentially more assessment areas
- Banks doing online lending, other non-facilities lending covered
- Banks with hybrid operations have their online, non-facilities lending activities covered
- Auto lending added

Operational and Compliance Buildout – Initially

- Mapping current CRA activities and program against new rule
- Look at internet, non-facilities lending (example, mortgage)
- Identifying gaps and shortfalls
 - What is needed - new product, new branches or sales offices, more sales personnel, more community service activities
 - If do a lot of community service through employees, does that have to be broadened?
- For Community Development and Community Service, consider more formalized programs for employees to do community development/service work, especially in new assessment areas
 - Paid time off for such activities?
 - Tracking employees' activities

Operational and Compliance Buildout – Initially

- Training
 - Having sales force and operations understand the focus on more products and assessment areas
 - Transition issues such as
 - A rural bank that goes into an urban area
 - An urban based bank that buys a rural bank
 - Addition or abandonment of new product line
 - Existing CRA personnel must understand that the “usual way” the bank operates does not suffice under the proposed rule, across definitions of assessment areas, products and data collection and analysis

Operational and Compliance Buildout Continues After the Initial Buildout

- The key is the seriousness and increased scope of reviews likely from agencies
 - Extensive data recording, maintenance, reporting
 - Deeper reviews and testing
 - Ongoing oversight
 - Regular reviews of data re appropriate assessment areas and product performance
- CRA examinations
 - Thorough review of data and processes before the exam
 - Self-identify issues and implement corrective steps
 - Gather information on community service and development activities, try to quantify (including employee activities)

Impact of Proposed Rule on Third Parties

Vendors

- Must be sure the bank has a clear window into operational efforts of originators, platform providers
- Ensure the vendor's data is accurate
- Vendor management is key - banks should be taking these steps already re vendors
 - Need agreements with strong reps and warranties
 - Need ability to look at vendor's operations, activities and data, and demand quick remedies

CRA data analysts and program consultants

- Their time has come
- Find good ones

Customers

Need to focus on obtaining and growing certain customer segments

- Multifamily
- Small businesses
- Individual consumers

Community Outreach

- Expanded efforts
- Get the company's Community Relations group integrated into and trained about the company's new CRA approaches and opportunities
- Community associations
 - Create strong connections
 - Find ways to partner with them to get referrals and access to customers

Interplay with Section 1071 Final Rule

- Definition of “small business” and “small farm” loans
 - Proposed to be consistent with the Section 1071 Final Rule
 - Means that small business and small farm definitions would contain same \$5 million gross annual revenue threshold
- Proposal retains the existing large bank data requirements for small business and small farm lending, but contemplates replacing the data requirements with the data collections under the Section 1071 Final Rule
- Proposes to make the compliance dates for a CRA final rule similar to the compliance date for the Section 1071 Final Rule

We're adjourned!



Michael C. Flynn

Co-Chair of the Financial Services

Regulatory Group

Buchalter

(303) 253-6750

MFlynn@Buchalter.com

Joel N. Cook

Principal & Practice Group

Manager

Aldrich & Bonnefin, PLC

(949) 474-1944

JCook@ABLawyers.com