Matching Financial Institution Community Development Activity with Community Credit Needs

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The purpose of the Community Reinvestment Act (CRA) is to ensure financial institutions help meet the credit needs of the communities in which they operate. One of the ways the Federal Reserve Bank of Boston assesses an institution's record of meeting those needs is by evaluating the extent to which the institution engages in community development (CD) activities.[1]

Financial institutions are evaluated under different CRA examination procedures on the basis of their asset-size classification. CD activities are evaluated during CRA examinations under either the Large Bank or the Intermediate-Small Bank (ISB) Examination Procedures. Whether a large bank or an ISB, an institution's CD activities should be consistent with the identified needs and opportunities in its community.

Needs and Opportunities

To gain an understanding of the credit and CD needs and opportunities in a financial institution's community, examiners obtain information from community, government, and civic organizations, and sources such as local housing authorities and small business development agencies. Financial institutions can benefit from collaborating with the same organizations.

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To receive CRA consideration, activities must meet specific regulatory requirements and have community development as their primary purpose.[2] CD activities will vary among institutions, depending on the particular characteristics of an institution's community and, at least to some extent, on the institution's available resources, sophistication, and staff expertise. Nevertheless, the need for CD activities is present in every sector of the economy and all institutions can help meet the need to some degree.

Communities composed primarily of low- and moderate-income (LMI) census tracts may have needs and opportunities that differ from communities composed primarily of middle- or upper-income census tracts. Furthermore, different geographies may be more conducive to certain CD activities. In geographies that have experienced a rise in foreclosures and absentee landlords, for example, a responsive CD activity may be to provide affordable-housing rehabilitation and construction loans. Construction and permanent financing of multifamily rental property serving LMI individuals is a qualified CD lending activity.

Consideration may also be given for activities in communities that government agencies have identified for redevelopment. A municipal bond to fund the renovation of a community facility or park that has been included in a redevelopment plan for an LMI neighborhood is an example of a qualified investment.[3]

CD activities, however, are not just about geography. Where LMI tracts are lacking, partnerships with community action agencies can assist institutions in reaching LMI individuals. For example, the need for basic banking access has been identified through CRA evaluations. Correlations have been noted between LMI individuals and underbanked and unbanked individuals, who rely on more-expensive, nontraditional forms of finance. In such circumstances, providing financial education that is coupled with low-cost checking and savings accounts and remittance services for those who send money to their countries of origin would likely qualify as CD services.

Bank Size

Although under Large Bank Examination Procedures, CD loans, investments, and services are all evaluated under the applicable test, under the Intermediate-Small Bank Examination Procedures, a separate and somewhat flexible community-development test is used. One bank's activities may tilt primarily toward loans while another's may tilt more toward investments or services. That approach allows an ISB to allocate resources among CD loans, investments, and services in amounts that it reasonably determines are most responsive to local needs and opportunities.[4]

CD activities may also differ in relative size, scope, complexity, or other factors, on the basis of bank size. It would not be reasonable to expect that a smaller, less complex institution would engage in the same activities, at least not to the same degree, as a larger, more complex institution. Further, a bank with a commercial-lending focus would more likely engage in activities that promote economic development by financing businesses or farms. Lending to small businesses might stimulate economic growth and provide employment to low- and moderate-income individuals. Such activity would qualify as a CD activity when specific size-eligibility standards are met.

It is important for institutions to understand the communities in which they operate in order to identify and, to the extent appropriate, deploy resources toward CD opportunities and needs.

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Endnotes

[1] Disclaimer: The views and opinions expressed in this document do not necessarily reflect those of the Federal Reserve Bank of Boston or the Board of Governors of the Federal Reserve System and should not be misconstrued as an endorsement or recommendation of any program or activity. The examples of community development activities described in this article are provided for illustrative purposes only. The Federal Reserve Bank of Boston does not guarantee that similar programs will receive favorable CRA consideration in the future. An institution's activities will be evaluated in accordance with the applicable Interagency CRA Examination Procedures to determine if those activities, with reference to the institution's performance context, meet the community development criteria necessary to receive CRA consideration. Community development activities include loans, investments, and services.

[2] Community development is defined in Regulation BB, at section 228.12(g).

[3] Qualified investment is defined in Regulation BB, at section 228.12(t).

[4] "Interagency Questions and Answers Regarding Community Reinvestment, Q&A § __.26(c)," *Federal Register* 75, no. 47, Thursday, March 11, 2010.