Consumer Finance Monitor Podcast (Season 9, Episode 52): OCC and FDIC's Proposed CRA Revisions: Are Banks Really Getting Regulatory Relief, and What Does the Future Hold for CRA?

Speakers: Alan Kaplinsky, Scott Coleman, Greg Thomas and Dr. Kenneth Thomas

Alan Kaplinsky:

Welcome to the award-winning Consumer Finance Monitor podcast, where we explore important new developments in the world of consumer financial services and what they mean for your business, your customers, and the industry. This is a weekly show brought to you by the Consumer Financial Services Group at the Ballard Spahr Law Firm. And I'm your host, Alan Kaplinsky, the founder and former practice group leader for 25 years and now senior counsel of the Consumer Financial Services Group at Ballard Spahr. And I'm delighted to be moderating today's program. For those of you who are seeking more information, either about the topic that we'll be discussing today, which I will introduce to you in just a moment, or any other topic in the world of consumer finance, don't forget about our blog. Also going by the name of Consumer Finance Monitor. We've hosted our blog since 2011 when the CFPB became operational.

So there's a lot of relevant industry content there. We also regularly host webinars on subjects of interest to those in the industry. So to subscribe to our blog or to get on the list for our webinars, you can visit us at ballardspahr.com. And if you like our podcast, please let us know about it. You can leave us a review on whatever platform you're using today to access our show. And also, please let us know if you have ideas for other topics that we ought to be covering or speakers that we should be considering as guests on our show. So today we're going to be discussing a very important development involving one of the most consequential and longest running issues in bank regulation. And that is the seeming never ending quest to amend the regulations implementing the Community Reinvestment Act, or as we'll refer to it from now on, the CRA.

On July 31, the comptroller of the currency and the FDIC published a joint notice of proposed rulemaking proposing what they describe as targeted amendments to their CRA regulations. The proposal represents a significant departure from the regulatory path that the federal banking agencies have been pursuing over the last several years. As many of our listeners, I'm positive will recall, in 2023, the OCC, the FDIC, and the Federal Reserve adopted a substantially revised CRA framework. And that rule was challenged by the banking industry. And in March 2024, the Federal District Court in Texas issued a preliminary injunction precluding the rule from going into effect. And the court concluded among other things that the agencies had likely exceeded their statutory authority in certain respects. The agency subsequently proposed in 2025 to rescind the 2023 rule and essentially return to the pre-2023 CRA framework.

But that is not what happened. Instead, the OCC and the FDIC have now proposed something considerably more interesting, retaining much of the existing framework, but making a series of targeted changes that would substantially reduce the regulatory burden on many banks. And there is another important thing to note here, said that the OCC and the FDIC have joined in this notice of proposed rulemaking, but where's the Federal Reserve Board? You won't find them mentioned in this NPRM. That raises an obvious question. Are we potentially headed toward a CRA regime in which different banks could be subject to different rules depending upon what federal banking agency supervises them? The proposal also contains some very significant changes for community banks. Perhaps the most important is the dramatic increase in the asset thresholds. The proposal would increase the definition of a small bank from less than approximately 412 million assets to less than a billion.

The intermediate bank category would extend from one billion to 10 billion, and a bank generally would not be considered a large bank for CRA purposes until it exceeded 10 billion in assets. The agencies are also seeking comment on these alternative thresholds. That could move hundreds of banks into less burdensome CRA exam categories. The proposal also would focus lending evaluations on major product lines, eliminate certain data reporting requirements for smaller banks, make significant changes to community development activities, create a formal process for banks to obtain confirmation that a particular

activity qualifies for CRA credit and make changes to strategic plans and public file requirements. But there are trade-offs involved here. For example, less CRA data could mean less transparency for community organizations and others who seek to evaluate whether banks are meeting the credit needs of their communities. And the proposal leaves largely intact, this is really important and we'll get into it later on in our program.

It leaves largely intact the current assessment framework, which remains heavily tied to a bank's physical location, even though banking as an industry has become increasingly digital. So there's a lot to discuss here and I'm particularly pleased with our guests today because they bring very different but complimentary perspectives to this subject. So our first guest is Dr. Kenneth H. Thomas, going to call him Ken. Ken is widely recognized as the country's leading experts on CRA. He taught banking and monetary economics at the Wharton School for 42 years. Has advised regulators and banks on CRA issues and has been deeply involved in CRA policy and reform for decades. He is also the founder and CEO of Community Development Fund Advisors.

Ken has been a frequent guest on another podcast show that we did and the webinar that we did, both of them of course, pertaining to the CRA. So Ken, a very warm welcome to you and I have been wanting to get you back on our podcast show and thank goodness the FDIC and the comptroller did something in the CRA area, so I had the perfect excuse. But I'm delighted to have you back in.

Kenneth Thomas:

Thank you, Alan, and it's certainly a pleasure to be back with you and Scott and your team on this very important topic.

Alan Kaplinsky:

And I'm very pleased that you told me about all the good work that your son Greg Thomas is doing in the area. Greg is the president and chief investment officer of Community Development Fund Advisors. Greg brings a very different perspective. Before joining the Community Development Fund, he spent more than two decades in investment management, including positions at Goldman Sachs, JP Morgan, and major hedge funds. His focus today includes working with banks on CRA investments and helping them balance community impact with investment performance. So Greg, if you're there, a very warm welcome to you.

Greg Thomas:

Thank you for having me. It's a real pleasure to be part of the discussion today.

Alan Kaplinsky:

And last but not least, I'm very pleased to introduce my colleague Scott Coleman, who has been part of the other webinar and the other podcasts that we've done previously with Ken. For 30 years now, it's probably more than 30 years, Scott has represented banks and bank holding companies in connection with mergers, stock purchase transactions, branch P&A transactions, capital raising, corporate restructuring, branching non-bank acquisitions, changes in bank control applications and charter conversions. He's also represented organizers seeking to form bank holding companies, apply for deposit insurance and charter new depository institutions. He has significant experience in a wide range of what I call pure bank regulatory matters, including Reg O, Reg W, Reg Y, Interstate Banking and branching, lending limits, Basel III and regulatory capital guidelines. He's also represented bank stock lenders and subordinated debt purchasers. And among many of the hats that he wears and very relevant to today's webinar is, he is an expert in this area of CRA.

And he and another colleague of ours, Beau Hurtig and I, we authored a recent blog on Consumer Finance Monitor dated August 10th analyzing this notice of proposed rulemaking. And I would commend that to your reading, but certainly not during this podcast show. So we have a lot to cover and I'm going to begin with a question to you, Ken. You've been following CRA, I would say almost since its inception in 1977. When you read this notice of proposed rulemaking, what was your immediate reaction? Is this the kind of CRA reform that you've been advocating for or are there other aspects here that were surprising to you?

Kenneth Thomas:

Well, yes, Alan, I've been with CRA since 1977 and whenever there are proposed changes, I always ask myself, "Is this what Senator Proxmire, the father of CRA, would've wanted?" I had the opportunity to know and work with him. And my short answer to the question regarding this NPR or NPRM is no, it's really not what he would've wanted and I don't believe he would've liked it. I believe he would actually be very upset that his CRA law, which will be 50 years old next year, has become a political football. The 1995 regs, which I worked on with former comptroller Gene Ludwig were endorsed by Senator Proxmire and they were apolitical and they made sense. They've passed the test of time with communities getting about $500 billion in CRA loans and investments each year, community groups getting $100 billion plus community benefit agreements on big mergers and 98% of banks passing their CRA exams.

But this all changed under Trump one in 2020 when two bankers, Joseph Otting and Steve Mnuchin from OneWest, came to DC and we had the first major rewrite of CRA, later rescinded by Biden who pushed the Fed's 2023 final rule, which was legally challenged, including my own amicus brief against it. And effectively rescinded under Trump two, laying the groundwork for the present NPR. Bottom line, none of these three proposed reforms were needed as we only needed to update and modernize the true and tested '95 regs to account for branchless banks and digital banking. The most surprising aspect I have to tell you of the current NPR is its specific attack on community groups with its 15% operating expense limit for eligible CRA donations, which I believe is the result of the very publicized and nasty battle between NCRC and KeyBank over their initial failure to renew their five-year community benefit agreement, which they later did to settle this very public mess.

Banks, especially those doing M&A deals, must be very careful entering into such CBAs with community groups because I believe they're like Hotel California agreements, you can check out anytime you like, but you can never leave. I preferred and I continue to prefer bank-controlled community benefit plans that have the same CD benefits as the community benefit agreements that are decided in the bank's boardroom rather than in the press.

Alan Kaplinsky:

Okay. Well, thank you. So it's interesting, Ken, that the one thing that you mentioned that you thought should have been done was ignored completely. That is the idea of changing the investment areas. They didn't make any changes there and that really I think is a terrible oversight. Well, let me go to you, Scott. Before we get into the individual provisions, could you give us maybe, and to the extent we haven't already covered it, the regulatory history that brought us here? In particular, why did we go from the 2023 CRA rule to the litigation and preliminary injunction, to the 2025 rescission proposal and now to this OCC FDIC proposal? And we're still not done because I think by the time the smoke clears, and I'm not sure when that's going to happen, all three agencies will be on board with something.

Scott Coleman:

Yeah, I think we've hit on some of this and I'll try to give the CliffsNotes version, but I'm going to go back to June of 2020. As Dr. Thomas mentioned, the OCC issued a major overhaul of its CRA regulation and it did so at the time alone. And I think that's relevant because we saw at the time one regulator out of alignment with the other two, in that case, the OCC going alone and the FDIC and the Fed potentially going another direction. As was already mentioned, that was then suspended and rolled back in May of 2021 when we returned to the 1995 framework. There were some positives about the 2020 rule. It intended to adopt objective evaluation standards. It attended to address, as the current rule does, expanded qualifying activities for community investment. It intended to reach broader geographically, but it was perceived as an easing of the burden on national banks.

It received a lot of opposition from community groups and others, and of course went by the wayside. We then saw the agencies act together. We covered that at the time in 2022 and 2023. Again, Dr. Thomas has talked about all of this, but I agree wholeheartedly that the key reform that was needed was to address where banks have assessment areas based on where they get deposits, and we'll talk about what the current rule maintains later. That was not in the 2023 rule. It intended to adopt new performance tests, new metrics, new assessment areas, and new data requirements that met significant industry opposition, which led to the case that you've mentioned and which Ken filed an amicus brief on.

Where we are now is that the OCC and the FDIC have basically in response to a preliminary injunction that was issued, announced their intent to rescind the rule with the Fed, and then they went a different direction. They tacked, right? So they removed themselves from the litigation. The Fed technically has not dismissed the litigation. The Fed did not join in this notice of proposed rulemaking, and that's where we are today, and we'll see where we go from here.

Alan Kaplinsky:

So Scott, when I first learned about the fact that the Fed was not part of this, I couldn't help but think that maybe this had a little something to do with the Fed's desire to show that they're an independent agency, that they're not really an executive agency like the OCC and the FDIC, and with the matter pending before the Supreme Court involving President Trump's desire to remove Lisa Cook as a Fed board member and all that brouhaha, that maybe that this might've had a little something, this might've been one of the reasons that they didn't want to appear as being too cozy with the OCC and FDIC. You think I'm off base? But that was my thought.

Scott Coleman:

Yeah, I think there's political issues here. Obviously the administration was agitating for a new chair and now has a new chair of the Fed. They were seeking to remove a member and reshape the Board of Governors. That may have something to do with it, but it's also the case that if you look at the 2020 OCC proposal and what was finally adopted and since repealed in '22, the Fed has consistently had a different view of what CRA should do, how it's measured and how it applies than the OCC does. And so the split isn't entirely a surprise, nor is it entirely a surprise we're here when the FDIC and OCC removed themselves from the litigation and the Fed did not.

Alan Kaplinsky:

Right. Got it. So Ken, let me go back to you. One of the most striking things about this notice of proposed rulemaking is that the OCC and the FDIC decided not simply to restore the '95 regulations. Instead, they're proposing some substantive amendments here. What do you think the agencies are trying to accomplish through that approach?

Kenneth Thomas:

Well, yes, this is a joint OCC, FDIC, NPR, but in my opinion, it's really 100% OCC Comptroller Jonathan Gould with Travis Hill and the FDIC acting as a cover band. Actually, when I first heard the name Travis Hill, I thought he was the country singer by the same name, but the FDIC guy like Gould is a lawyer, unlike Otting, who was a former banker. The OCC and the FDIC, their marching orders are simple, deregulate as much as possible and as quickly as possible before the 2028 election. But their current NPR is not deregulation, but almost a form of reregulation. Because even if it goes into effect, and that's a big if with consumer group possible litigation, it'll end up costing banks more. Let me explain. So far, we're zero for two on CRA reform. And even if this somehow gets passed in its current form, which Kalshi and Polymarket will likely put in the 10% to 25% range, it will not take effect until at least 2028 or likely 2029.

Meanwhile, the banks, especially the hundreds being shifted into new exam procedures, will have spent millions preparing for these new regulations, which will likely may not happen. One top four bank told me they had 23 people working around the clock preparing for the 2023 final rule with its ridiculous lending-based assessment areas. They wasted millions of dollars. When I spoke before the largest CRA and fair lending meetings a few years ago, I went on record that the 2023 final rule would be legally challenged and never go into effect. And I cautioned bankers not to spend any time or money preparing for something that wouldn't happen. Federal Reserve attendees at two different meetings, and we're talking about several dozen attendees in both cases, were very upset with my comments and let the organizers at the conferences know. I haven't been invited back since then, but no problem. Theirloss, not mine.

Alan Kaplinsky:

Well, I've invited you back.

Kenneth Thomas:

Thank you.

Alan Kaplinsky:

So that I'm sure is made up for any oversight by any other conferences. So Scott, I want to go back to you now. We noted that the Fed participated in the 2022 proposal, the 2023 final rule and the 2025 rescission proposal, but it didn't join this. Do you have any insight other than what we just talked about as to the Fed's approach? And could we actually end up, do you think, with CRA regimes that are going to depend upon who is supervising the bank? Do you think that is actually ever going to happen?

Scott Coleman:

I don't think it's going to happen, in part because I'm skeptical that we'll get the reform that's contemplated by this proposed rulemaking. It's clear that the Fed could have signed on and did not choose to. It's also clear they could change their mind later. I do think the prospects for a split are somewhat less remote than you might think. It was one thing for the OCC to go it alone in 2020 when they were making it easier for institutions and it would, in theory, draw institutions who felt like they would benefit from that framework.

If the Fed is going to have a rule that's more onerous than the other two regulators, there's a real risk that any state member banks would consider moving to be regulated by the FDIC instead, which I think makes it hard for the Fed to continue to go it alone. I think we'll eventually see some form of re-enproachment, but that's not clear and certainly we could see a split. They could just revert to the 1995 rule and keep it there. And we'd have two different rules depending on who your regulator was and no fix of the real problem.

Alan Kaplinsky:

Yeah. Yeah. All right, let's turn to a different area and something I've called the big change, the asset size thresholds. And my question for you, Ken, is, and I mentioned it earlier during my introductory remarks, but let me remind everybody, the proposal would raise a small bank threshold to a billion dollars in assets and the intermediate banks ceiling to 10 billion. The agencies estimate that approximately 604 FDIC supervised banks would move from intermediate small to small bank status. What does that mean for CRA exams? And more importantly, for what those banks actually have to do to demonstrate CRA compliance? Do you have any other insight you want to share with our listeners as to the real world effects of this change?

Kenneth Thomas:

Alan, there's really absolutely no rationale for these one billion or $10 billion levels other than being nice round numbers. Who decides what asset levels make a community bank? Why not 30 or 50 billion? The current 412 million small bank and 1.6 billion ISB thresholds are fine, and banks have learned to live with them. Under the current regs, small banks can always get extra credit for CD activities to upgrade to an outstanding rating. And ISB banks can opt in under large bank procedures, although more data is required. So banks have alternatives under the current regime. If they lead, they'll get a better rating, but remember, not all banks want to be outstanding. Many CEOs tell me that they're happy with being satisfactory. They want to blend in with the 90% of other banks. When you're outstanding, community groups come asking for money and other things, and when you're at the top, there's only one way to go.

Greg's got some really interesting ratings data to suggest that some ISB and large banks may want to continue to be examined under their current status, even though the NPR allows them the option to go to these exam alternate procedures. This is a very important finding for such banks who are comfortable with their existing exam and data collection procedures and may not want to spend the time or money to see how they would fare under an alternative procedure, especially if it's way in the future, and it may not even come to fruition. Remember, we're 0 for two so far on CRA reform.

Alan Kaplinsky:

Yeah. So Scott, from a legal and a regulatory perspective, why do you think the agencies chose one billion and 10 billion other than the fact that it was around round numbers? And what should banks think about the alternative thresholds they were asking about, including the SBA aligned thresholds and the possibility of a $30 billion intermediate bank ceiling?

Scott Coleman:

So I think there's no legal basis for the $1 billion threshold. I think it was picked solely because it was a round number and because they could point to the data to indicate that that would cover about 80% of all supervised institutions, even though those institutions control less than 5% of industry assets. The $10 billion floor makes more sense because that is a long-standing number used in Prudential regulation. 10 billion is the statutory threshold, for example, for Dodd-Frank's CFPB supervision, for the Durbin Amendment interchange fee caps for heightened stress testing levels. That makes more sense. Mathematically, the $10 billion level represents less than 3% of US Bank charters, but those US banks hold approximately 85% of the total banking assets. I think that makes sense. And then banks in between, of course, are the intermediate banks that they remain accountable for community development activities with less burden.

The alternatives proposed for the regulators to see comment on, the SBA aligned threshold, that makes some sense where it would set a small bank cap of 850 million and an intermediate bank cap at 3.252 billion. That's another figure that is used in this case by another federal agency to determine the type of institution. I think probably the community banks by and large most are fine with that if it was picked instead of a billion. The 30 billion cutoff Would be great for intermediate banks. It would be great for the $10 billion banks. It would really be a shift in the institutions that are subject to the full array of Community Reinvestment Act assessments. And I don't think it's going to go anywhere because the community backlash is going to be so great that it just doesn't seem practical to me.

Alan Kaplinsky:

Right, right. Okay. Well, Greg, I almost forgot about you, but I know you're still there. So I do have some questions for you. And my first question, Greg, is that from the perspective of a bank that's just moved from intermediate small to the small status, what changes practically, and does the elimination of the community development test materially change the bank's incentives to make CRA qualified investments?

Greg Thomas:

I think first we need to look at the numbers and size up the context of what we're discussing. There's approximately 600 FDIC banks and 200 OCC banks or 800 banks in total approximately that are proposed to move down from the ISB to small bank procedures. We have a database of almost every CRA performance evaluation that's ever occurred. So we've gone through the numbers, we know what these banks invest, we know who they are, what their size is. And collectively those 800 banks we estimate have approximately $500 billion in assets. That compares to a $26 trillion banking industry in the US. So only by the numbers, they represent about 2% or so of US banking assets. And if we look at the banks $500 billion and above, there's nine of them. So say this would be the 10th biggest bank collectively, these 800. And that doesn't really size up the impact though, because to the point that these 800 smaller banks, they actually have more of a community network.

They have a smaller radius of local services and activities than they do. They're oftentimes in more rural areas. So we can't just look at the 2% because this disproportionately impacts smaller communities relative to the large national banks that I referenced earlier. So let's get to the question on the incentive. It depends. Strictly from a regulatory standpoint, of course, there's no longer regulatory requirements to do community development activities. However, from a community as well as a CRA strategy incentive, the answer is different. In fact, if you look at the exam procedures from a current ISB bank or proposed intermediate bank relative to a small bank, a small bank is only evaluated on its lending. There's a single lending test and they can get extra credit for community development activities. Intermediate banks, it's 50/50, it's half lending and half community development activities.

Well, be careful what you wish for because 23% of intermediate banks are getting an outstanding rating on community development activities, but only 7% get outstanding on lending. So if you remove the community development test, and we're

only talking about this cohort of 800 banks, it's possible that they're removing the buffer, which they have more control and flexibility on and could impact their overall rating if they decide to be a small bank.

Alan Kaplinsky:

Wow. You make a good point, Greg. I want to turn to another area, and that is what happens to community development. I mean, you touched on it during your last response. And again, I'm going to stay with you, Greg, for a little bit here. The proposal makes substantial changes to community development activities. It also creates a formal process under which a bank can ask regulators in advance whether a particular activity qualifies for CRA credit. Greg, your firm works with banks that are making CRA investments. From your perspective, how valuable would that advance confirmation process be, and would it change the way that banks approach CRA investing? The Community Development Fund emphasizes its investment strategy allows banks to target investments geographically, including by county and census tract and focuses on affordable housing for low and moderate income borrowers and renters. So anyway, what's your response?

Greg Thomas:

We referenced the 2023 final rule earlier. As we all know, it was a complete disaster. However, one of the positives of it was this exact concept that we're discussing now, which is the advance confirmation of community development investments. We think this would be very valuable, particularly for banks where qualifications are not obvious. So a practical challenge that banks face today is that they make an investment now, but ultimately CRA treatment may not be evaluated until years later when they have the exam. Banks and bankers are naturally conservative, especially when multiple groups are involved such as treasury, compliance, legal, CRA. And if there's any uncertainty about whether an investment qualifies or geographically where they'll get consideration, banks don't like surprises and it will delay or kill the process. Banks want their team focused on balance sheet efficiency, liquidity, risk adjusted returns and yield on their investments.

And this additional friction caused by that uncertainty certainly has prevented investments in the past from getting through. Now our fund, the Community Development Fund, we have a 10-year track record of receiving CRA credit for every single bank investor that's invested in our fund, in the geography they wanted. We can say that upfront and that eliminates a lot of the conversations that smaller firms may have. That track record is very powerful and establishes immediate credibility, but that's not the case for many other highly impactful investment strategies. And I think certainty has a real value in CRA investing. So if a bank can resolve the CRA question before it commits capital, more good investments should get approved.

Alan Kaplinsky:

Right, right. Greg, let's talk about the investment side for a minute. Your fund has made approximately 500 million in affordable housing investments since 2016. What kinds of CRA investments do you think will remain attractive to banks under this proposed framework if it becomes final? And do you expect demand to increase or decline?

Greg Thomas:

Because over time there have definitely been certain trends and themes that have developed in CRA investments. I would say the three biggest are more of a focus on returns and liquidity, improved documentation, and then improved or more impactful investments or qualitative elements of the investments. Historically on the first point, CRA investments have been perceived as a tax to banks. I speak to a treasurer or a CFO and they roll their eyes, "Oh my gosh, another CRA investment. It's like they're writing a check and they'll never see the money again." I was in the American Banker a couple of months ago discussing this very point and how my Wall Street background and being a hedge fund manager has addressed those concerns and why we built the fund the way that we have to address the liquidity and return profile. But over time, we've definitely seen more of a focus on the financial characteristics of investments.

That's a trend that will definitely continue. Documentation. Banks don't want to invest $10 million and just know it's invested... They want to know it's in a CRA vehicle. They want to know where it's going to go, which assessment areas, which counties, how many families benefited. These impact metrics, they want them documented and they want to show the examiner because they're going to get extra credit for that. And finally, there's been increasing focus on qualitative characteristics. Now under the NPR that was published, they specifically address responsiveness of investments. That's critical.

When we used the word complex during my hedge fund days, complex is a bad word. You start a conversation and say, "I've got a really complex investment for you," you go on to the next idea. But in the CRA world, complex, that's a good word. And so that's why it's important for these banks to combine the compliance and the finance teams in the same conversation.

Now, Ken, back in the CRA Handbook, I think that was in 1998, he established the Thomas 1% rule for CRA investments. That rule says, as a rule of thumb, 1% of assets in investments, that's pretty good for an outstanding rating. And there are other considerations, but that really caught on and bankers have remembered that. And they say, "How much do we have? What is our level of CRA investments?" And that's the 80%, 90% of the conversation. Over time, we've developed a framework which we call "The C-R-A of CRA investing. That stands for complexity, responsiveness, and activity levels. We didn't make that up. The regulators actually have a matrix that they publish showing that examiners evaluate banks on the level of complexity, responsiveness and activity levels in their investments. And an investment of a lower dollar amount can actually get higher CRA credit if it's deemed to be more responsive and complex.

The NPR addressed this issue and talked about responsive investments, including complex investments and how they'll receive additional credit. So historically going back to the returns, there's oftentimes an inverse correlation between more complex and innovative investments having a lower return and lower liquidity. And so that's exactly what we changed with our fund. We're trying to deliver high CRA impact with complexity and responsiveness, but also at a 20% risk weighting and daily liquidity. Now the activity levels, we can't forget about that. Of course, coming back to the 1% rule, that's important. That number has gone much higher since 1998. It's no longer 1%, but there's about a dozen characteristics or considerations we look at that determine what that number is for banks. And we have an algorithm internally that we use and we plug in for the bank depending on who we're speaking to, and we make recommendations based on the activity level.

But I'll leave you with this point on the qualitative considerations of an investment. We've done a multi-variable regression analysis on every performance evaluation that's publicly available. And we looked at cohorts of banks stripping out any of the non-controllable variables, banks of similar sizes, and of similar time periods. Banks that have extensive use of complex investments relative to banks that have no use of complex investments require considerably less dollar amount of CRA investments for the same rating on CRA. So, as we look forward, the NPR does focus on responsiveness of CRA investments, and I expect that to continue to be an important part of the conversation.

Alan Kaplinsky:

Okay. Thank you. Ken, there's another change that I find particularly interesting, and that is for intermediate banks, the proposal would eliminate the requirement that a bank receive a satisfactory rating on the community development test in order to receive an overall satisfactory rating. Strong lending performance could offset weaker community development performance. Do you see that as a fundamental change in the philosophy of CRA?

Kenneth Thomas:

Well, I just don't think that's a good idea because the ISB concept was created to ensure that as banks get larger, they have more community development responsibilities in addition to just basic lending. ISBs have a 50% weighted CD test and large banks, as you get even larger, have separate 25% each investment and service tests. A basic rule in CRA that goes back to Senator Proxmire in 1977 is simple, we expect more from bigger banks simply because they in turn receive more government benefits. Quid pro quo. The biggest banks, including those over a hundred billion as we saw in 2023, are often too big to fail and get preferential treatment compared to smaller banks. So we, again, always expect more from bigger banks. Once a bank has grown to an ISB status, it has a 50% CD requirement that could be met with three different CD buckets, loans, investments, or services, depending on a bank's evaluation of the CD needs within its assessment areas. That current passing CD test requirement should remain for ISBs to get a passing rating. The NPR proposal is just not good public policy in my opinion.

Alan Kaplinsky:

Okay. I'd say you made that pretty clear. So a question for you, Greg. The proposal would significantly increase the size thresholds. How do you think the changes will affect CRA ratings overall, especially outstanding ratings?

Greg Thomas:

That's an outstanding question, and that's something that we should ask the FDIC and OCC. We went through the 2023 final rule. It was incredibly complex, 650 pages. And as we went through all the text, there were two small tables and footnotes, one of which said if this passed, they looked at existing banks and they said 10% of them would fail. That was incredibly valuable. We didn't have to go through every single detail. They told us 10% of banks would fail under the 2023 final rule. Additionally, there was another table under the final rule of '23 that said every bank over 50 billion in assets would not receive an outstanding rating on the lending test. That was crazy. As everyone on this podcast knows, those banks are the lifeblood of every community in the United States. If they don't have incentives to be outstanding, they'll stop.

We don't have anything like that for this. And I've run the numbers, we've made our own estimates, but I would love for the regulators to tell us what they think would happen because it's not obvious. For example, as Ken mentioned, not every bank wants to be outstanding. They want to blend in with the other 90%. They may not have the same objectives. But if you already have outstanding, look, I think those banks are going to want to keep outstanding and they keep up the good work, keep your foot onthe pedal. If a bank is satisfactory and they want to upgrade to outstanding, don't just go to a different exam procedure and think that's going to happen because it won't. In fact, outstanding, 20% of large banks get outstanding, only 10% of ISB banks get outstanding. It's not obvious by changing exam procedures and going down an exam level that it is going to help your rating go to outstanding.

Those banks that may want to get outstanding, we should have a separate conversation with them and give them strategies and specific ideas on how they can improve those ratings, but not from downshifting. Similarly, as we discussed earlier, if you're ISB going to a small bank, be careful what you wish for. The lending test is rigid. It's tough. That's the business model of the bank and it's very long-term in nature. Community development activities where they have the option on the ISB exam to influence, you can have a bigger impact and more control over that. So, any bank that is targeting outstanding, they should really consider opting in to their existing exam procedures if given the option. And of course, always plan for the worst and hope for the best, but don't spend too much time on it. As we discussed earlier, the earliest we think this would happen, even if it did happen, would likely be 2028 or 2029. We'll have a new administration at that point anyway, and it may not be worthwhile to do the exercise.

Alan Kaplinsky:

Right, right. Okay. Let's turn to assessment areas for a brief moment. We've talked about it already, but let's really nail it down. One area, and this is for you, Ken, where the proposed rulemaking doesn't make a major change is in assessment areas. The agencies acknowledge that customers are increasingly geographically dispersed, but they continue to focus largely on a bank's physical facilities. Is that approach still workable in 2026? And how does it affect community banks that have expanded significantly through online and mobile banking but have relatively few branches?

Kenneth Thomas:

This is without a doubt the biggest flaw in the current NPR. The failure to update CRA to modernize it to account for branchless banks, namely credit card, FinTech, and internet banks that harvest deposits from all over the nation, but only have a CRA requirement for their place-based home office, usually Delaware, South Dakota, or Utah. Senator Proxmire emphasized that CRA must focus on reinvesting deposits in the form of loans back into their source communities. That's why he called it a reinvestment act. I estimate branchless banks harvest at least two trillion or 10% of our nation's total deposits, mainly from our big cities. But they have no CRA requirement to reinvest since the '95 regs are place-based well before we had internet banking. Some branchless banks, however, are increasingly reinvesting in those deposit sourcing markets, and that's a good trend. When comptroller Otting was preparing the first major CRA reform, he invited me to his office a few times where I explained this problem and my proposed 5% deposit reinvestment rule.

Any bank that had more than 5% of its deposits from an area must reinvest a proportionate amount in that area. He agreed with my suggestion and included a variant of the 5% requirement in his final rule. But that, as we know, was ultimately rescinded. In summary, there's three types of assessment areas, place-based ones from the '95 regs where a bank has an office, loan-based ones like the retail lending assessment areas and ORLAs or Outside Retail Lending Area from the Fed's 2023 final rules that make no sense, and deposit-based ones, which the previous OCC NPR had, but the current one does not have.

Banks and other interested parties have an opportunity to comment on this, and I submitted the first comment at regulations.gov, and it was totally on this topic why I believe this was a disaster and we should not even consider it because it fails to modernize CRA. That's what we're supposed to be doing. Reforming and modernizing CRA, it doesn't do it.

Alan Kaplinsky:

Yeah. So Scott, I'm just wondering, do you share the same thoughts that Ken has about this being a really big flaw in this proposal?

Scott Coleman:

I do, and maybe I've been listening to Dr. Thomas on too many podcasts and webinars, but I agree wholeheartedly. The nature of the industry has changed. Where deposits are sourced and how they're sourced has changed. And if we're going to really maintain a community reinvestment framework, we've got to change how we measure where those assessment areas are.

Alan Kaplinsky:

Right, right. So Scott, let's turn to strategic planning right now. The proposal attempts to make a strategic plan option more workable by providing for pre-filing consultation, clarifying the process involved in that. Is this likely to make strategic plans more attractive to banks?

Scott Coleman:

It'll improve things on the margins, but I don't think it's going to make it substantially more attractive. I think we should be clear that although pre-filing consultation is helpful, and I've seen institutions that, for example, because they were changing regulator and adopting a strategic plan in that process, have gone through consultative processes effectively, the reality is if you're an institution that can satisfy the CRA test without a strategic plan, it's less burdensome to do so, and you're going to want to keep doing that. Strategic plans become attractive for banks whose business model doesn't fit with the standard tests. That is that they've got a specialized product line, they've got an unusual geographic footprint, or they're pursuing a non-traditional community development strategy. Those are the institutions that benefit from a strategic plan and being able to define their own evaluation criteria, and the reform processes are helpful for those institutions, but we would advise most institutions that if you can comply with your CRA requirements without a strategic plan, you should continue to do so.

Alan Kaplinsky:

Right, right. Ken, only a relatively small number of OCC and FDIC supervised banks currently operate under strategic plans. Why haven't these strategic plans been more popular, and do you expect that to change?

Kenneth Thomas:

Only 19 OCC banks, 48 FDIC banks have submitted strategic plans. Counting the 12 from the Fed, that's just 79 out of more than 4,200 banks, less than 2%. I agree with Scott. I expect to see more strategic plans since the OCC previously and now with the FDIC and the NPR has considerably streamlined these requirements. This will be especially attractive to banks with fewer than half their loans by number or dollar amount inside their assessment areas, or those not certain about the impact of the proposed NPR or even what the Fed may do. But I agree with Scott very much. Under the current regs, you are allowed to have less than 50% in dollar or number amount inside your assessment areas if you show your performance context relative to your business plan. We've worked with a lot of banks that are under 50% and they've passed that because we show it's part of their performance context, their business strategy, that they can do it.

So the current regs do allow for it. You don't have to have a strategic plan. I've never been a fan of that. Go back to 1997. I wrote an article in the ABA Banking Journal that that was my biggest problem with the '95 regs. I don't believe in self-regulation, which is essentially what a strategic plan is. I don't believe self-regulation has any place in American banking. And I should mention that there are some strategic plans with CD targets that equal or exceed the 1% rule, so that's a good thing. But in general, I don't recommend it unless there's an extreme case.

Alan Kaplinsky:

Yeah. So I'm going to throw a question to you, Scott, out of left field. It doesn't deal with this proposal, but why don't you tell our audience, because they may not be thinking about it so much, and that is that there are a lot of states that have CRA laws, right? I mean, I don't know how many, but there are a lot of them. And as far as I know, the federal CRA law doesn't preempt them. And what can you tell our audience about that?

Scott Coleman:

Yeah, there are a handful of states that do have their own CRA requirements. In some states, financial institutions that are subject to federal CRA are exempt and state CRA applies to, for example, mortgage companies and others. But in other states, we do see that you have to satisfy the state's requirement. That's not going to go away. And if anything, if we looked at the current proposal and if it was adopted, and if it was seen by states and community groups as a push away from the traditional CRA requirements, as we've discussed and as Dr. Thomas has talked about, I think we might see the states become more active.

Alan Kaplinsky:

Yeah. Okay. Well, Ken, we're going to talk now about, we're getting toward the end of our program and we're going to have to wrap it up fairly quickly, but what should banks be doing now? I guess they ought to be writing comment letters for starters if there's something that they don't like. But if you were, Ken, if you were advising a $500 million bank, a $2 billion bank, and an $8 billion bank today, and I just pulled those numbers out of thin air, they're nice and round, what would you tell each of them to be thinking about as they analyze the proposal, assuming it becomes final?

Kenneth Thomas:

Well, first of all, again, like you said, assuming it becomes final, regardless, they need to understand the NPR and be able to explain it to their CEO and their board, because they're going to be asked about it. I would not recommend, however, anyone spending serious time or money on it, especially hiring outside consultants when we're zero for two on CRA reform, especially going into the 2028 election. At $500 million, they should continue their CD activities as an ISB because they can be used as extra credit toward outstanding as a small bank. If they're weak on CD activities, then they would be advised to put all their eggs in the four small bank lending test ratio basket. A $2 billion bank, they should continue separate investment and service test activities, which again can be used as important CD activities as an ISB.

However, with strong investment and service test results and a familiarity with data collection in large bank rules, they might consider opting in for continued review as a large bank. That would especially be the case for an $8 billion bank. Existing large banks have their entire data collection and CRA system set up for large bank treatment. So why change it, especially if their growth or next M&A deal would push them over $10 billion?

Alan Kaplinsky:

Okay. And Greg, what would you tell the banks that are currently invested in CRA? Can they assume that their investment strategy should change if this proposal ends up becoming final?

Greg Thomas:

Some of what we talked about earlier is I would just keep their foot on the pedal, business as usual. CRA investments, they typically have a long lead time. They need to be planned in advance. And our recommendation is to not change what you're doing. We've seen this before, as was discussed, CRA proposals have been zero for two recently and there's a lot to work through, and even if it does go through, it's a 2028 or 2029 situation. Now, CRA has a three-year look back, so a lot can change with the administration, with politics, and while enforcement may be low currently, the surveillance cameras are running and they will be used against you in the future. So that's the advice that we give banks, and it's good to run scenarios. If it is cost-effective for the bank, you want to have an idea of where you would stand, but do not spend too much time on it and keep doing what you're doing.

Alan Kaplinsky:

Right. So here's my final question. I'm going to pose it to all three of you and we'll do it in, well, I was going to say age order. I'm not sure about whether we'll do that. But we'll go with you, Greg, at the beginning. Let's end this up with a prediction. If the OCC and the FDIC ultimately adopts something that's close to this proposal, what do you think CRA compliance look like three years from now? And what do you think will be the most significant consequence for banks and the community CRA is intended to benefit? So we'll go to you first then we'll go to your dad and finally, Scott.

Greg Thomas:

I would say my most certain prediction is more uncertainty three years from now. But getting past the political calendar I would have to say, we're going to be in a similar trend that we've seen over the past 30 years.

When I analyzed stocks in my prior life, I didn't just look at the last 12 months or five years. I'm looking over long periods of time and there are definitely secular trends that occur and that are occurring in compliance and CRA related compliance and community activity. As we look forward, I would expect it to be more of the same and probably angst and uncertainty around something else at that point in time.

Alan Kaplinsky:

Okay. Ken?

Kenneth Thomas:

Even if this NPR ultimately goes into effect, and that's like assuming the LA Clippers are in the NBA Finals this year, which we know is not going to happen, a bank being examined in the summer of '29 would be reviewed based on lending and other activity from say 2026 to 2028 under the existing '95 regs. Activities during '29 may be reviewed under the new regs on a split exam, but that'd be very complicated for examiners and the banks. By 2029, we'll have a new administration and the political football will once again be kicked the opposite way perhaps, with the new final rule maybe being rescinded, once again, making us 0 for three. Bottom line, with CRA's golden anniversary next year, 50 years, the best result in honor of Senator Proxmire, in my opinion, would be to maintain the '95 regs, but update them with the 5% deposit rule and basically keep some of the good ideas from the past reforms, like the list of allowable CD activities and the required CRA public file posting online. Thank you.

Alan Kaplinsky:

Yeah. And Scott, final word.

Scott Coleman:

I think I'm going to agree with Greg and Ken. I'm not a betting person and I don't play the predictive markets, but if I did, I would bet we're operating under the 1995 rule.

Alan Kaplinsky:

Okay. Well, we've come to the end of our show today. First, of course, I want to thank all of our guests, and I'm including you, Scott, as a guest in this situation, although you're a different type of guest. So thank you, Greg. Thank you, Ken. Thanks, Scott, for participating in today's program. There's one thing I will definitely predict, and that is this will not be the last podcast or webinar that we're going to be doing on this topic. It certainly gives us a lot of fodder for doing podcasts or webinars. Finally, I want to thank all of our listeners, of course, of taking the time to listen to our show today, and I hope everybody enjoys the remainder of their day. Thank you again. Okay.