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Recent Changes to the Community Reinvestment Act and Their Impact on Community Banks and Rural Economies

I. INTRODUCTION

E.V. Wilson, known as “Jugs” to his friends and family, runs a small, family business called “One Stop” in Ruleville, Mississippi.¹ He originally opened One Stop as a restaurant and convenience store and has since expanded it to include a laundromat and gas station.² The business is doing so well that Wilson recently financed first homes for his son and daughter.³

Southern Bancorp, a rural bank holding company with \$500 million in total assets, claims One Stop as its own success story.⁴ Southern Bancorp’s mission is to promote economic development in rural Arkansas and the Mississippi Delta.⁵ It is the parent company of Delta Southern Bank,⁶ which provided Wilson with a loan to start One Stop.⁷ Since its inception in 1988, Southern Bancorp’s banks have originated more than \$146 million in development loans⁸ that have created or saved more than 7,000 jobs in Arkansas.⁹

1. See Southern Bancorp, Making a Difference: Success Stories, http://www.southerndevelopmentbancorp.com/makingADifference_successStories.htm (last visited Nov. 18, 2005).

2. *Id.*

3. *Id.*

4. *Id.*

5. See Southern Bancorp, Getting to Know Southern, <http://www.southerndevelopmentbancorp.com/gettingToKnow.htm> (last visited Nov. 18, 2005).

6. See Southern Bancorp, Getting to Know Southern: The Southern Family, http://www.southerndevelopmentbancorp.com/gettingToKnow_family.htm (last visited Nov. 18, 2005) (Delta Southern Bank is a member of the Southern Bancorp family).

7. See Southern Bancorp, *supra* note 1. Delta Southern Bank is a full-service bank located in Ruleville, Mississippi. It has \$125 million in total assets and is a certified Community Development Financial Institution. *Id.*

8. See Southern Bancorp, Making a Difference: Impact Numbers and Statistics, http://www.southerndevelopmentbancorp.com/makingADifference_impact.htm (last visited Nov. 18, 2005). Development lending is directed at promoting economic development by financing small businesses or farms and the revitalization or stabilization of low- and moderate-income communities. See Southern Bancorp, Making a Difference: Development Lending by Region, http://www.southerndevelopmentbancorp.com/makingADifference_DevelopmentLending.htm (last visited Nov. 18, 2005).

9. See Southern Bancorp, Making a Difference: Impact Numbers and Statistics,

Just as Southern Bancorp claims a role in the success of One Stop, federal financial regulators partly attribute Southern Bancorp's success to the Community Reinvestment Act ("CRA").¹⁰ Passed by Congress in 1977, the CRA encourages banks to provide credit access to low- and moderate-income neighborhoods in their communities.¹¹ Since its enactment, the CRA has been the subject of intense debate.¹² Some analysts contend that the CRA has provided important, substantial benefits to low-income communities.¹³ For example, studies have found that the CRA has increased home mortgage lending, small business lending, and community development investment.¹⁴ Other analysts, however, argue that the CRA is overly burdensome on financial institutions and that the costs outweigh the benefits.¹⁵ They attribute increased lending and investment in low-income communities to other market factors.¹⁶

http://www.southerndevelopmentbancorp.com/makingADifference_impact.htm (last visited Nov. 18, 2005). Southern Bancorp's banks have also provided services such as affordable housing development, workforce development, asset building, business development, and advocacy for the poor. *Id.*

10. See Lawrence B. Lindsey, Fed. Reserve Bd., *The Future of Rural America*, <http://minneapolisfed.org/pubs/region/95-06/reg956b.cfm> (last visited Nov. 18, 2005) ("Another CRA success in rural areas involves the Southern Development Bancorporation."); see also The Center for Rural Strategies, Campaign to Save CRA: Field Stories, http://www.ruralstrategies.org/cra/vid_clips.html (last visited Nov. 18, 2005) (providing examples of CRA-related success stories in rural areas).

11. 12 U.S.C. § 2903(a) (2005).

12. See *infra* notes 13-20 and accompanying text.

13. See, e.g., Michael S. Barr, *Credit Where It Counts: The Community Reinvestment Act And Its Critics*, 80 N.Y.U. L. REV. 513, 561 (2005) (presenting empirical evidence that the CRA helps overcome market failures and discrimination).

14. *Id.* at 565-67, 576-78 (citing studies that the CRA has increased access to home mortgage credit, small business loans, and community development investment in low-income communities); see also Nat'l Community Reinvestment Coalition, *CRA Commitments*, http://www.ncrc.org/policy/cra/documents/2005-09-21_CRACCommitmentsUpdated.pdf at 1, 1 (last visited Nov. 18, 2005) (claiming that more than \$4.2 trillion in CRA commitments have flowed to minority and low-income neighborhoods since 1977); Robert E. Litan, DEPT. OF TREASURY, *THE COMMUNITY REINVESTMENT ACT AFTER FINANCIAL MODERNIZATION: A FINAL REPORT* (2001), available at <http://www.treas.gov/press/releases/reports/finalrpt.pdf> (providing evidence that CRA has had a positive effect on bank and thrift lending in low- and moderate-income communities).

15. See, e.g., Jonathan R. Macey & Geoffrey P. Miller, *The Community Reinvestment Act: An Economic Analysis*, 79 VA. L. REV. 291, 293-94 (1993) (finding the CRA does more harm than good); Michael Klausner, *Market Failure and Community Reinvestment: A Market-Oriented Alternative to the Community Reinvestment Act*, 143 U. PA. L. REV. 1561 (1995) (arguing the CRA is an inefficient solution to the credit access problems of low-income communities).

16. See Macey & Miller, *supra* note 15; see also Barr, *supra* note 13, at 568 (other

In the past decade, federal regulators and legislators have attempted to improve the CRA's effectiveness by increasing accountability for banks.¹⁷ Typically, this has been accomplished by new regulations or stricter enforcement of old regulations.¹⁸ Recent revisions to CRA regulations, however, demonstrate a new focus on reducing the regulatory burden on smaller banks.¹⁹ Critics oppose such changes on the grounds that they will "weaken" the CRA and drastically reduce the incentives for banks to provide investments and services in low-income areas, particularly rural areas.²⁰

This Note analyzes the likely impact of the new CRA regulations on community banks and rural areas. Community banks should benefit from lower CRA compliance costs and more rural areas are CRA-eligible under the new regulation.²¹ Although some rural areas may realize a decrease in CRA-related community investment and services, such an impact is likely to be insignificant.²² Part II describes the purpose and history of the CRA.²³ Parts III and IV discuss rural areas and community banks in order to establish the context for a proper analysis of the impact of the CRA on these sectors.²⁴ Parts V and VI discuss the most recent revisions to the CRA regulations and assess their likely impact on community banks and rural areas.²⁵

factors contributing to growth in lending to low-income borrowers may include general economic growth, financial and technological innovation, and consolidation in the financial services sector).

17. See *infra* notes 50-57 and accompanying text.

18. See *id.*

19. See *infra* notes 58-75 and accompanying text.

20. See, e.g., Silver, *infra* note 139 and accompanying text.

21. See *infra* Parts V.A.3, V.B.3, V.C.3, VI.

22. *Id.*

23. See *infra* Part II.

24. See *infra* Parts III, IV.

25. See *infra* Parts V, VI.

II. THE PURPOSE AND HISTORY OF THE CRA

In 1977, Congress enacted the Community Reinvestment Act in order to eliminate the practices of “redlining” and “community disinvestment” by financial institutions.²⁶ Redlining refers to the systematic denial of credit to persons in minority or low-income neighborhoods.²⁷ Historically, financial institutions have practiced redlining, particularly in urban areas.²⁸ In some cases, banks “literally drew red lines on maps around minority or low-income areas that were to be avoided” by not opening branch locations and denying loan requests.²⁹ Often, these red lines were drawn based on racial considerations instead of economic factors.³⁰ Community disinvestment, which is often associated with redlining, occurs when banks accept local deposits and reinvest the funds outside the community of origin.³¹ Congressional hearings have found a “direct correlation between the divestment of lending institutions in inner city communities and severe and precipitous urban blight.”³² Together, redlining and disinvestment remove financial resources from low-income communities and produce a debilitating cycle of decreased homeownership and property values.³³

The purpose of the CRA is to encourage banks to meet the credit needs of their entire community, including low- and moderate-income areas, consistent with safe and sound banking practices.³⁴ Under the CRA, Congress requires the four federal bank supervisors, agencies which include the Office of the Comptroller of the Currency

26. See 123 CONG. REC. 17, 604 (1977) (Sen. Proxmire, the Congressional sponsor of the CRA, states that the CRA “is intended to eliminate the practice of redlining by lending institutions.”); see also A. Brooke Overby, *The Community Reinvestment Act Reconsidered*, 143 U. PA. L. REV. 1431, 1453-54 (1995) (citing community disinvestment as a problem addressed under the CRA).

27. See Marcia Johnson et al., *The Community Reinvestment Act: Expanding Access*, 12 KAN. J.L. & PUB. POL’Y 89, 91 (2002).

28. See *id.* at 91.

29. Barr, *supra* note 13, at 516, n.5.

30. Johnson et al., *supra* note 27, at 90-91.

31. See *id.* at 92.

32. Susan R. Jones, *Planting Money Where It’s Needed Most: A Look at the Community Reinvestment Act After 25 Years*, BUS. L. TODAY 47, 48 (Nov./Dec., 2003).

33. See Johnson et al., *supra* note 27, at 93.

34. 12 U.S.C. § 2903(a) (2005).

("OCC"),³⁵ the Federal Reserve Board ("FRB"),³⁶ the Federal Deposit Insurance Corporation ("FDIC"),³⁷ and the Office of Thrift Supervision ("OTS"),³⁸ to 1) assess every institution's record of meeting community credit needs and 2) consider such record when evaluating an institution's application for a deposit facility.³⁹ The agencies must establish performance criteria,⁴⁰ examine each depository institution, write an evaluation of the institution's performance, and assign the institution a rating.⁴¹ The CRA ratings are based substantially on a bank's record of lending in low- and moderate-income areas in which the bank operates.⁴² Although no direct sanction is applied to banks with low CRA ratings, the agencies must consider the institution's CRA record in evaluating applications for a new charter, deposit insurance, branch openings, branch relocations, and mergers or acquisitions.⁴³

Initially, the CRA had little impact on lending practices and was the focus of intense criticism.⁴⁴ Several factors weakened the CRA in the late 1970s and early 1980s.⁴⁵ First, the four agencies never denied an application for a new deposit facility on CRA grounds during this time period.⁴⁶ As a result, banks had little incentive to comply with the CRA regulations.⁴⁷ Second, the agencies did not publicly disclose an

35. The OCC regulates national banks. 12 U.S.C. § 2902(1)(A) (2005).

36. The FRB regulates bank holding companies and state-chartered commercial banks which are members of the system. 12 U.S.C. § 2902(1)(B) (2005).

37. The FDIC regulates state-chartered banks and savings banks which are not members of the Federal Reserve System and the deposits of which are insured by the Corporation. 12 U.S.C. § 2902(1)(C) (2005).

38. The OTS regulates savings associations (which have deposits that are insured by the FDIC) and savings and loan holding companies. 12 U.S.C. § 2902(1)(D) (2005).

39. 12 U.S.C. § 2903(a) (2005).

40. See 12 U.S.C. § 2901(b) (2005) (requiring the agencies to use their authority when examining financial institutions and to encourage such institutions to help meet the credit needs of the local communities).

41. 12 U.S.C. § 2906(b)(2) (2005) (requiring the agencies to assign to each institution one of the following CRA ratings: "outstanding," "satisfactory," "needs to improve," or "substantial noncompliance").

42. See *infra* notes 114-21 and accompanying text.

43. See 12 U.S.C. §§ 2903(a)(2), 2902(3) (2005).

44. See Barr, *supra* note 13, at 524.

45. See *infra* notes 46-49 and accompanying text.

46. See Barr, *supra* note 13, at 524.

47. See Macey & Miller, *supra* note 15, at 300. The CRA does not automatically sanction banks for failing to meet CRA requirements. Rather, the agencies merely encourage banks to comply by threatening to disapprove applications for new deposit facilities based on poor ratings. Because the agencies did not enforce this threat in the late 1970s and early 1980s, banks had less incentive to comply with CRA requirements. See *id.*

institution's ratings and performance evaluation, thereby failing to harness the power of public pressure to meet the CRA goals.⁴⁸ Third, the agencies focused on process-oriented evaluations, such as time spent at board meetings discussing community needs, rather than on objective performance measures and results.⁴⁹

In the late 1980s, however, the CRA gained strength as the agencies and legislators intensified oversight and adopted tougher guidelines.⁵⁰ For example, in 1989, an agency rejected a merger application on CRA grounds for the first time.⁵¹ This action "demonstrated that there could be serious consequences for poor CRA performance," particularly in the context of increasing interstate banking and the resulting merger activity.⁵² In the same year, Congress amended the CRA to require the banking agencies to publicly disclose an institution's CRA rating and performance evaluation, thereby increasing public pressure for banks to perform well.⁵³ In 1995, the agencies adopted new regulations to focus evaluations on objective performance measures rather than subjective, process-oriented factors.⁵⁴ For example, these new regulations created "large" and "small" categories for banking institutions and applied separate performance criteria to each category.⁵⁵ Finally, some aspects of the CRA were

48. See Barr, *supra* note 13, at 524. Initially, disclosure requirements directed institutions to post a CRA notice at each branch. This notice informed the public of methods of accessing an institution's past CRA Statements and submitting comments about the institution's CRA compliance. See 12 C.F.R. § 228.6 (1993).

49. See Barr, *supra* note 13, at 524.

50. See *infra* notes 51-57 and accompanying text; see also Macey & Miller, *supra* note 15, at 301 (stating the agencies began to enforce the CRA more strictly beginning in 1989 and adopted significantly tougher standards).

51. See Barr, *supra* note 13, at 524.

52. See *id.*

53. See Macey & Miller, *supra* note 15, at 301 ("By requiring the publication of ratings, the amendment subjected the supervisory agencies to political pressure from groups claiming that the agencies were not doing enough to ensure CRA compliance.").

54. See Robert B. Avery et al., *Community Banks and Rural Development: Research Relating to Proposals to Revise the Regulations that Implement the Community Reinvestment Act*, FED. RESERVE BULLETIN (Fed. Reserve Bd., Washington, D.C.), Spring 2005, at 202, available at http://www.federalreserve.gov/pubs/bulletin/2005/spring05_research.pdf.

55. See *infra* note 113 and accompanying text. Prior to the 1995 regulations, all institutions were evaluated using the same performance criteria, regardless of the size of the institution. The 1995 regulations defined small banks as those with less than \$250 million in assets and large banks as those with \$250 million or more in assets. See Avery et al., *supra* note 54, at 203.

strengthened in 1999 with the passage of the Gramm-Leach Bliley Act (“GLBA”).⁵⁶ Under the GLBA, all of a holding company’s depository institutions must have at least a “satisfactory” CRA rating in order for the holding company to be designated a financial holding company and engage in newly authorized financial activities, such as certain insurance and securities functions.⁵⁷

As part of the 1995 regulatory revisions, the federal banking agencies committed to review the amended regulations for their effectiveness in “placing performance over process, promoting consistency in evaluations, and eliminating unnecessary burden.”⁵⁸ This review began in July 2001 with an advance notice of proposed rulemaking that requested public comment on whether the 1995 regulations were effective and whether any changes should be made to the rules.⁵⁹ Based on approximately 400 comments, the agencies issued a joint proposed rule in February 2004 (“February 2004 Proposal”) that would have increased the small bank asset threshold from \$250 million to \$500 million.⁶⁰ As a result, banks with less than \$500 million in assets would be considered “small” banks and would be evaluated under more streamlined criteria than “large” banks with assets of \$500 million or greater.⁶¹

Banking institutions and community organizations were severely split on the February 2004 Proposal.⁶² Banking institutions wanted additional regulatory relief, while community organizations generally opposed any change that would allow more institutions to be evaluated under the streamlined test applied to small banks.⁶³ Based on the feedback, the agencies announced in July 2004 that they would not

56. See Barr, *supra* note 13, at 526.

57. See 12 U.S.C. § 1843(l)(2) (2005). For a bank to form a financial subsidiary to engage in financial activities, the bank must receive at least a “satisfactory” CRA rating. 12 U.S.C. §§ 24a(a)(7), 1831w(a) (2005).

58. CRA Regulations, 70 Fed. Reg. 44,256, 44,257 (Aug. 2, 2005).

59. See CRA Regulations, 69 Fed. Reg. 5,729 (Feb. 6, 2004).

60. *Id.*

61. Small banks were evaluated solely on streamlined lending criteria and were exempt from all CRA data reporting requirements. Large banks were evaluated based on more extensive lending, investment, and service criteria and had to report CRA data on small business, small farm, and community development loans. See *infra* notes 113-20 and accompanying text.

62. See CRA Regulations, 70 Fed. Reg. at 44,257.

63. See *id.*

proceed with their February 2004 Proposal.⁶⁴ Subsequently, the OTS and the FDIC pulled out of the joint rulemaking process.⁶⁵ In August 2004, the OTS unilaterally published a final rule that raised the threshold for small savings associations to \$1 billion.⁶⁶ The FDIC proposed a similar rule.⁶⁷ The OCC and the FRB disagreed with these actions by the OTS and the FDIC and initially refused to increase the threshold above \$500 million.⁶⁸

Then, in March 2005, the FRB, the OCC, and the FDIC published a new joint proposal (“March 2005 Proposal”) that raised the threshold to \$1 billion, but added a new “community development” test for banks with between \$250 million and \$1 billion in assets, which were dubbed “intermediate small banks.”⁶⁹ The March 2005 Proposal generated over 10,000 public comments.⁷⁰ Like the February 2004 Proposal, banking institutions sought more relief, and community organizations strongly opposed raising the small bank threshold.⁷¹ However, according to the agencies, both sides “recognized that the proposal had the potential to strike an appropriate balance between the need to provide meaningful regulatory relief to small banks and the need to preserve and encourage meaningful community development activities by those banks.”⁷²

In August 2005, the FRB, the OCC, and the FDIC issued a joint final rule that was very similar to the March 2005 Proposal and it

64. *Id.*

65. *Id.*

66. See CRA Regulations, 69 Fed. Reg. 51,155 (Aug. 18, 2004) (codified at 12 C.F.R. § 563e.12(t)); see also *infra* notes 215-19 and accompanying text. In March 2005, the OTS also adopted a final rule, effective April 1, 2005, that allows a thrift that is evaluated as a large retail institution to determine the weight that will be assigned to lending, investments, and services in its CRA evaluation. See CRA Assigned Ratings, 70 Fed. Reg. 10,023, 10,023 (Mar. 2, 2005).

67. See CRA Regulations, 69 Fed. Reg. 51,611 (Aug. 20, 2004). The proposed rule would also have added to the small bank test a sixth criterion taking into account a bank’s record of community development lending, investments, or services. In addition, it would have expanded the definition of “community development” in rural areas. Finally, the proposal asked for comment on whether such community development activities should be evaluated as a separate test. *Id.*

68. See Barr, *supra* note 13, at 517-18.

69. CRA Regulations, 70 Fed. Reg. 44,256, 44,257-58 (Aug. 2, 2005).

70. *Id.* at 44,258.

71. *Id.* at 44,257-59.

72. *Id.* at 44,258.

became effective on September 1, 2005.⁷³ This Note analyzes the recent changes, including the revisions by the OTS, and their likely impact on community banks and rural populations.⁷⁴ In order to provide context for this analysis, however, this Note first briefly discusses rural areas and community banks as defined under the CRA.⁷⁵

III. DEFINING RURAL AMERICA

A. *What is a "Rural" Area?*

The CRA uses the terms "metropolitan" and "nonmetropolitan" to refer to urban and rural areas respectively.⁷⁶ A metropolitan area is a metropolitan statistical area ("MSA") as defined by the Director of the Office of Management and Budget ("OMB").⁷⁷ The OMB defines an MSA as an area "associated with at least one urbanized area that has a population of at least 50,000."⁷⁸ In other words, a metropolitan area has a population of at least 50,000 or is associated with an area that has such population.⁷⁹ In 2000, an estimated 232 million people, or approximately eighty-three percent of the national population, lived in metropolitan areas.⁸⁰

The banking agencies define a nonmetropolitan or rural area as an area that is not located in an MSA.⁸¹ In other words, a rural area has a population of less than 50,000 and is not associated with an urbanized

73. *Id.* at 44,256.

74. *See infra* Parts V, VI.

75. *See infra* Parts III, IV.

76. *See* CRA Regulations, 70 Fed. Reg. 44,256, 44,261-62 (Aug. 2, 2005).

77. 12 U.S.C. § 2906(e)(2) (2005) (defining "metropolitan area" as any MSA, as defined by the OMB, "with a population of 250,000 or more, and any other area designated as such by the appropriate Federal financial supervisory agency"); 12 C.F.R. § 228.12(r) (2005) (FRB defining MSA as "a metropolitan division as defined by the Director of [the OMB]"); 12 C.F.R. § 25.12(r) (2005) (OCC defining MSA); 12 C.F.R. § 345.12(r) (2005) (FDIC defining MSA).

78. Standards for Defining Metropolitan and Micropolitan Statistical Areas; Notice, 65 Fed. Reg. 82,228, 82,238 (Dec. 27, 2000), available at <http://www.census.gov/population/www/estimates/00-32997.pdf>. The MSA "comprises the central county or counties containing the core, plus adjacent outlying counties having a high degree of social and economic integration with the central county as measured through commuting." *Id.*

79. *Id.*

80. *See* Economic Research Service ("ERS"), U.S. DEPT OF AGRICULTURE, <http://www.ers.usda.gov/Briefing/Rurality/WhatisRural/> (last visited Nov. 18, 2005).

81. 12 C.F.R. §§ 228.12(s), 25.12(s), 345.12(s) (2005).

area that has a population of 50,000 or more.⁸² In 2000, an estimated 49.2 million people, or seventeen percent of the national population, lived in nonmetropolitan areas.⁸³ In 1993, the U.S. had 2,276 nonmetropolitan counties, accounting for eighty three percent of the nation's land area.⁸⁴

B. *Economic Challenges Facing Rural Areas*

Rural areas in the United States face numerous economic challenges.⁸⁵ For example, rural areas have a poverty rate approximately twenty-five percent higher than urban areas.⁸⁶ Of the 500 poorest counties in the country in 1999, over ninety percent were rural.⁸⁷ Over seven million people living in rural areas, including a disproportionate number of minorities, live below the poverty line.⁸⁸

Rural areas also have less access to affordable credit compared to urban areas.⁸⁹ Most rural areas "have a limited range of financial institutions relative to metropolitan areas."⁹⁰ For example, in 2000, twenty-three percent of rural counties were served by two or fewer banks, compared to just three percent of urban counties.⁹¹ Rural interest rates are higher on average than rates in urban areas and rural mortgages have shorter maturities on average than urban mortgages because there is less competition between financial institutions in rural areas.⁹²

82. See *supra* note 78 and accompanying text.

83. See ERS, *supra* note 80.

84. Joint Center for Housing Studies, Harvard University, *The Community Reinvestment Act: Access to Capital in an Evolving Financial Services System 1*, at 93 (2002), available at <http://www.jchs.harvard.edu/publications/governmentprograms/cra02-1.pdf>.

85. See *infra* notes 86-92 and accompanying text.

86. See Rural Poverty Research Center, <http://www.rprconline.org/research.htm> (last visited Nov. 18, 2005). The percentage of urban populations with incomes below the poverty line is 10.8%. The corresponding rural poverty rate is 13.4%. *Id.*

87. *Id.*

88. *Id.*

89. See Letter from AARP et al. to Donald E. Powell, FDIC Chairman (Sept. 9, 2004), available at <http://www.ruralstrategies.org/cra/fdic.html> ("rural counties have 4.3 banks compared to 10.9 banks in urban areas, on average").

90. Joint Center for Housing Studies, *supra* note 84, at 96.

91. *Id.*

92. *Id.* at 95-96. In 1995, fixed interest rate mortgages in rural areas were seventeen basis points higher than in urban areas. Thirty-year fixed and adjustable rate mortgages constituted eighty percent of all rural mortgage loans, compared to ninety percent of urban mortgage loans. *Id.*

IV. THE ROLE OF COMMUNITY BANKS IN RURAL AMERICA

A. *The Current Economic Role of Community Banks*

Community banks are most commonly defined as banking institutions with assets of less than \$1 billion.⁹³ In 2003, they constituted approximately ninety-four percent of all banks in the nation,⁹⁴ yet they held only 13.5% of total banking industry assets, 16.7% of total deposits, and operated 33.7% of all banking offices.⁹⁵ In rural areas, however, community banks provide a more substantial share of banking services.⁹⁶ They operate fifty-eight percent of all banking offices and hold forty-nine percent of all deposits in rural areas.⁹⁷ In some rural areas, community banks are the *only* providers of banking services.⁹⁸

Community banks are also significant providers of credit to the small business⁹⁹ and small farm¹⁰⁰ segments of the economy.¹⁰¹ In 2003,

93. Although there is no single definition of a community bank, this is the most common definition used by banking analysts. See Federal Reserve Bank of Kansas City, *The Role of Community Banks in the U.S. Economy*, ECON. REV. 15, 17 (Second Quarter 2003), available at <http://www.kc.frb.org/PUBLICAT/ECONREV/PDF/2q03keet.pdf>.

94. See Tim Critchfield et al., *The Future of Banking in America*, 16 FDIC BANKING REV. 1, 1 (2004), available at <http://www.fdic.gov/bank/analytical/banking/2005jan/article1.pdf>. The number of community banks has declined significantly in the past twenty years due to consolidation in the banking industry. For example, the number of community banks fell from 14,351 in 1985 to 7,337 in 2003. *Id.* at 2.

95. *Id.* at 3. These percentages have also dropped significantly in the past twenty years. In 1985, community banks held 25.8% of total assets, 29.1% of total deposits, and 47.2% of total offices. *Id.*

96. See *infra* notes 97-98 and accompanying text.

97. See Federal Reserve Bank of Kansas City, *supra* note 93, at 21 (indicating that community banks in less populated states such as Kansas, Iowa, and North Dakota account for over seventy percent of all bank branches and sixty percent of all deposits).

98. See Joint Center for Housing Studies, *supra* note 84, at 97 (noting that, in 2000, approximately seventy-three percent of rural counties were served exclusively by local banks and seventeen percent were served solely by small banks).

99. See Federal Reserve Bank of Kansas City, *supra* note 93, at 24 (defining small business as a firm with fewer than 500 employees). Small businesses "account for just over a half of private sector output and employment and provide two-thirds to three-quarters of net job growth." *Id.*

100. The Small Business Administration ("SBA") defines "small farms" as those with sales of less than \$500,000. ERS uses a \$50,000 threshold while the National Commission on Small Farms uses a \$250,000 threshold. See ERS, U.S. DEP'T OF AGRICULTURE, <http://www.ers.usda.gov/Briefing/FarmStructure/glossary.htm#smlfarm> (last visited Nov. 18, 2005).

101. See Federal Reserve Bank of Kansas City, *supra* note 93, at 24-27.

for example, community banks provided almost one-third of all small commercial and industrial loans and more than forty percent of small commercial real estate loans.¹⁰² In the same year, community banks provided sixty-five percent of all farm real estate loans, sixty-one percent of all farm operating loans, and roughly seventy-five percent of small farm loans.¹⁰³

B. *The Future Economic Role of Community Banks*

Community banks should continue to play an important economic role in the near future by serving smaller markets in which larger banks have no interest and by specializing in relationship-based services.¹⁰⁴ Community banks possess competitive advantages as lenders to small businesses and small farmers through their “ability to assess the risks of borrowers who lack long credit histories, to process soft data such as borrower reputations, or to operate effectively in situations where the proximity of decision making to customers is important.”¹⁰⁵ Moreover, many customers “may prefer the more personal approach of community banks.”¹⁰⁶

Due partly to their competitive advantage in relationship-based services, community banks have experienced relatively strong growth rates, sustained profitability, and increased rates of entry in recent years.¹⁰⁷ For example, a recent study showed that assets and deposits at small banks grew several percentage points faster than at large banks during the 1990s.¹⁰⁸ Community banks’ share of the small business loan market also increased from 1994 to 2000.¹⁰⁹ Since 1993, community banks have “tended to earn a healthy return on assets” (“ROA”)

102. See Critchfield et al., *supra* note 94, at 4 (defining small business loans as \$1 million or less at origination and small farm loans as less than \$500,000 at origination).

103. *Id.*

104. See Federal Reserve Bank of Kansas City, *supra* note 93, at 39.

105. See Critchfield et al., *supra* note 94, at 28.

106. *Id.* (citing as evidence the emergence of new community banks in areas where large, non-local banks have taken over local community banks).

107. *Id.* at 24.

108. Federal Reserve Bank of Kansas City, *supra* note 93, at 31 (excluding the effects of merger and partly attributing faster growth at small banks to the fact that they offer higher deposit rates than large banks).

109. See Critchfield et al., *supra* note 94, at 10.

comparable to that of the twenty-five largest banking organizations.¹¹⁰ Many new community banks continue to be chartered.¹¹¹ Several of these new banks were opened in markets in which large banks had acquired smaller banks, “suggesting that a substantial number of depositors and borrowers still prefer the personal service that community banks tend to provide.”¹¹² These solid performance measures suggest that community banking is a “viable business model” and community banks “should continue to occupy an important position in the banking industry for the foreseeable future.”¹¹³

V. REVISIONS TO THE CRA BY THE OCC, THE FRB, AND THE FDIC

A. *Increase in Size Threshold for Small Banks from \$250 Million to \$1 Billion*

1. The Old Regulation

Under the old regulation, “small” banking institutions were defined as those 1) with assets of less than \$250 million and 2) not affiliated with a holding company with assets greater than \$1 billion.¹¹⁴ These institutions were eligible for streamlined evaluations based solely on lending activity¹¹⁵ and were exempt from CRA data reporting obligations.¹¹⁶

“Large” banking institutions were defined as those 1) with at least \$250 million in assets or 2) any institution affiliated with a holding

110. *Id.* at 15. However, smaller institutions have tended to have a lower return on equity (“ROE”) than larger institutions. *Id.*

111. See Federal Reserve Bank of Kansas City, *supra* note 93, at 32.

112. *Id.*

113. See Critchfield et al., *supra* note 94, at 28.

114. 12 C.F.R. §§ 228.12(u)(1), 25.12(u)(1), 345.12(u)(1) (2005).

115. A small bank’s performance is evaluated based on the following lending criteria: the bank’s loan-to-deposit ratio, including community development loans or other qualified investments; the percentage of loans located in the bank’s assessment area(s); the bank’s record of lending to borrowers of different income levels and businesses and farms of different sizes; the geographic distribution of the bank’s loans; and the bank’s record of taking action, if warranted, in response to written complaints about its performance in helping to meet the credit needs in its assessment area. 12 C.F.R. §§ 228.26(b), 25.26(b), 345.26(b) (2005).

116. 12 C.F.R. §§ 228.42(a), 25.42(a), 345.42(a) (2005) (exempting small banks from the CRA requirement to collect and report data on small business, small farm, and community development loans).

company with at least \$1 billion in assets.¹¹⁷ These institutions were evaluated based on a three-part test comprised of a lending test,¹¹⁸ an investment test,¹¹⁹ and a service test.¹²⁰ Large institutions were required to report data annually on small business, small farm, and community development loans.¹²¹

2. The New Regulation

The new regulation increases the asset threshold for small institutions from \$250 million to \$1 billion, without regard to holding company affiliation, and creates a new subcategory of small institutions called “intermediate small institutions.”¹²² Intermediate small institutions are those with assets of at least \$250 million and less than \$1 billion.¹²³ These dollar figures are adjusted annually for inflation and published by the agencies.¹²⁴ The purpose of these changes is to

117. 12 C.F.R. §§ 228.12(u)(1), 25.12(u)(1), 345.12(u)(1) (2005).

118. 12 C.F.R. §§ 228.22, 25.22, 345.22 (2005) (defining the lending test for large banks). The lending test accounts for fifty percent of the CRA rating and measures lending activity for many types of loans, including home mortgage, small business, small farm, and community development loans. The assessment criteria are: the proportion of an institution’s loans in its assessment areas; the distribution of lending across borrowers of different incomes; the distribution of lending across census tracts of different incomes; the extent of community development lending; and the use of innovative or flexible lending practices to address the credit needs of low-income individuals. *Id.*

119. 12 C.F.R. §§ 228.23, 25.23, 345.23 (2005) (defining the investment test for large banks). The investment test accounts for twenty-five percent of the CRA rating and measures qualified investments that benefit an institution’s assessment area or a broader area that includes its assessment area. *Id.* A qualified investment is a lawful investment, deposit, membership share, or grant that has community development as its primary purpose. 12 C.F.R. §§ 228.12(t), 25.12(t), 345.12(t) (2005).

120. 12 C.F.R. §§ 228.24, 25.24, 345.24 (2005) (defining the service test for large banks). The service test accounts for twenty-five percent of the CRA rating and measures the availability of an institution’s system for delivering retail banking services. The assessment criteria include the geographic distribution of an institution’s branches and the availability and effectiveness of alternative systems for delivering retail banking services (such as automated teller machines) in lower-income areas and to lower-income persons. *Id.*

121. 12 C.F.R. §§ 228.42(a), 25.42(a), 345.42(a) (2005).

122. 12 C.F.R. §§ 228.12(u)(1), 25.12(u)(1), 345.12(u)(1) (effective Sept. 1, 2005).

123. *Id.*

124. 12 C.F.R. §§ 228.12(u)(2), 25.12(u)(2), 345.12(u)(2) (effective Sept. 1, 2005). The dollar figures are adjusted “based on the year-to-year change in 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.” *Id.*

provide “important regulatory relief for community banks.”¹²⁵ Regulatory relief is accomplished in two ways.¹²⁶ First, banks with less than \$1 billion in assets are no longer evaluated under the more stringent, three-part test applied to large banks.¹²⁷ Second, and more importantly, these banks are exempt from mandatory data collection and reporting requirements related to small business, small farm, and community development loans.¹²⁸

3. The Impact on Community Banks and Rural Populations

According to a study conducted by the Independent Community Bankers of America in 2002, the mean cost in employee time for CRA compliance was \$84,445 per year for small banks with average assets of \$216 million, and about \$30,000 more per year for large community banks with average assets of \$666 million.¹²⁹ These estimates include all compliance costs, including those associated with data collection and reporting requirements under the old regulation.¹³⁰ Because community banks are exempt from these requirements under the new regulation, they should realize some costs savings.¹³¹ In theory, these savings would make community banks more competitive in the marketplace and perhaps translate into reduced borrowing costs for individuals and small businesses in rural areas.¹³²

Critics argue that the average CRA employee costs, as a percentage of assets, are negligible; therefore, any potential savings under the new regulation would be insignificant.¹³³ However, this

125. CRA Regulations, 70 Fed. Reg. 44,256, 44,258 (Aug. 2, 2005).

126. See *infra* notes 127-28 and accompanying text.

127. CRA Regulations, 70 Fed. Reg. at 44,258.

128. *Id.* at 44,259.

129. See Michael S. Barr, *Credit Where it Counts: Maintaining a Strong Community Reinvestment Act* 1, 3 (May 2005), available at http://www.brookings.edu/metro/pubs/20050503_cra.pdf.

130. *Id.*

131. See Letter from Karen M. Thomas, Executive Vice President, Independent Community Bankers of America (ICBA), to the FDIC (Oct. 20, 2004), available at <http://www.icba.org/advocacy/commentlettersdetail.cfm?ItemNumber=3853&sn.ItemNumber=1711>. But see Barr, *supra* note 129, at 4 (stating that new regulations might lead to high transition costs).

132. See Letter from Karen M. Thomas, *supra* note 131.

133. See Barr, *supra* note 129, at 3-4 (citing study that average CRA employee costs as a percentage of assets were 0.0017 percent for large “community” banks and 0.039 percent

argument fails to consider the potential for substantial costs savings in the aggregate.¹³⁴ First, approximately ninety-five percent of all state nonmember banks qualify as small banks under the new regulation and are exempt from CRA data collection and reporting requirements.¹³⁵ Second, and more importantly, research indicates that the number of status-changing institutions is likely to be significant.¹³⁶ For example, one study used 2003 as a test year and estimated that approximately 1,621 banking institutions would have changed in status from “large” under the old regulation to “intermediate small” or “small” under the new regulation.¹³⁷ If all of these status-changing institutions benefit from lower compliance costs, the total aggregate savings could be too large to ignore and may result in substantial savings to community bank customers.¹³⁸

Critics of raising the threshold also argue that eliminating data collection and reporting requirements for small business, small farm, and community development loans will reduce public pressure on community banks and weaken the impact of the CRA.¹³⁹ This argument relies on three key assumptions.¹⁴⁰ First, elimination of the data collection and reporting requirements will result in reduced public access to information.¹⁴¹ Second, reduced public access to CRA-related information will result in less public accountability for banks.¹⁴² Third,

for small banks). In addition, transition costs between the old regulation and the new regulation may reduce savings. *Id.* at 4.

134. See *infra* notes 135-37 and accompanying text.

135. See LISSA L. BROOME & JERRY W. MARKHAM, REGULATION OF BANK FINANCIAL SERVICE ACTIVITIES at 456 (2d ed. 2004).

136. See Avery et al., *supra* note 54, at 207.

137. *Id.* These “status-changing” institutions constituted eighteen percent of all institutions subject to CRA and held thirteen percent of the deposits. *Id.*

138. See *supra* notes 135-37 and accompanying text.

139. See Memorandum from Josh Silver, Vice President of Research and Policy, National Community Reinvestment Coalition (NCRC), to NCRC members 1, 4 (Summer 2005), available at http://www.ncrc.org/policy/cra/documents/Memo_on_final_CRA_ruling.pdf.

140. See *infra* notes 141-49 and accompanying text.

141. See *infra* notes 144-47 and accompanying text.

142. See John Taylor, *Weakening the CRA Will Hurt Everyone*, AM. BANKER, May 27, 2005, at 10 (“Eliminating publicly available data on small-business and farm lending of midsize banks would abolish the most effective means of public accountability for ensuring that these major small-business lenders are reaching small firms in all communities, including low-and moderate-income ones.”).

public accountability plays a role in pressuring banks to engage in CRA-eligible activities.¹⁴³

The agencies have responded to the first assumption by pointing to substitute sources of information.¹⁴⁴ For example, Call Report data provides the public with annual outstanding amounts of small business and small farm loans.¹⁴⁵ The CRA performance evaluation itself still includes, as appropriate, a description and summary of small business lending, small farm lending, and community development loans.¹⁴⁶ However, despite the availability of substitute sources of information, some data is no longer publicly available.¹⁴⁷ Moreover, the fact that the available data is no longer consolidated in a single, uniform format makes it less accessible for monitoring purposes.

Although some data is either no longer publicly available or less accessible, and assuming that the second assumption is logically sound, the issue is whether or not public access to CRA data plays a significant role in pressuring community banks to perform well. Many community organizations have demonstrated a strong willingness and ability to use CRA data to gain leverage on financial institutions.¹⁴⁸ Typically, these are more active and sophisticated organizations located in urban areas; as a result, their focus tends to be on larger banks in urban areas rather than community banks in rural areas.¹⁴⁹ Furthermore, any sophisticated organization that is focused on community banks is more likely to have the ability and resources to find and utilize information using the substitute sources.

143. See *infra* notes 148-51 and accompanying text.

144. CRA Regulations, 70 Fed. Reg. 44,256, 44,259 (Aug. 2, 2005).

145. *Id.* Every national bank, state member bank, and insured non-member bank is required by the Federal Financial Institutions Examination Council ("FFIEC") to file consolidated Reports of Condition and Income (i.e. Call Report) for each calendar quarter. The specific reporting requirements depend on the size of the bank and whether or not it has any foreign offices. See FDIC, Call/TFR Information, http://www2.fdic.gov/Call_TFR_Rpts/inform.asp (last visited Nov. 18, 2005).

146. CRA Regulations, 70 Fed. Reg. at 44,259.

147. See *id.* For example, Call Report data lacks loan-location and business-size information included in the old CRA data reports. *Id.*

148. See generally Macey & Miller, *supra* note 15, 333-40 (discussing the influence of activist groups using CRA data to "extract" payments from depository institutions).

149. See, e.g., Woodstock Institute in Chicago, <http://www.woodstockinst.org/> (last visited Nov. 18, 2005) (a CRA watchdog group in Chicago).

B. *The New Community Development Test for Small Intermediate Banks*

1. The Old Regulation

The CRA measures community development performance by banks.¹⁵⁰ Under the old regulation, a small bank was evaluated for community development loans only,¹⁵¹ not investments and services.¹⁵² A large bank, on the other hand, was evaluated for community

150. See *infra* notes 184-90 (defining community development).

151. 12 C.F.R. §§ 228.12(h)(1), 25.12(h)(1), 345.12(h)(1) (2005) (defining a community development loan as a loan that “has as its primary purpose community development”); see also FFIEC, Community Reinvestment Act: Interagency Questions and Answers Regarding Community Reinvestments, 66 Fed. Reg. 36,620, 36,627 (July 12, 2001), available at <http://www.ffiec.gov/cra/pdf/qa01.pdf> (defining primary purpose). Examples of community development loans include loans to: borrowers for affordable housing rehabilitation and construction; nonprofit organizations serving primarily low- and moderate-income housing or other community development needs; borrowers to construct or rehabilitate community facilities that are located in low- and moderate-income areas or that serve primarily low- and moderate-income individuals; Community Development Financial Institutions (CDFI) and Community Development Corporations (CDC); local, state, and tribal governments; and borrowers to finance environmental clean-up or redevelopment of industrial site as part of an effort to revitalize the low- or moderate-income area in which the property is located. *Id.* at 36,626.

152. See *supra* note 115 and accompanying text.

development loans, investments,¹⁵³ and services¹⁵⁴ under the three-part test.¹⁵⁵

2. The New Regulation

Under the new regulation, intermediate small banks are evaluated under a two-part test which consists of the lending test and a new “community development” test.¹⁵⁶ In order to achieve an overall “satisfactory” rating, an institution must receive at least “satisfactory” ratings on both parts of the test.¹⁵⁷ The lending test evaluates the institution’s retail lending based on the same streamlined criteria used for small institutions.¹⁵⁸ The community development test is weighted equally to the lending test and evaluates the institution’s overall community development record, including loans, investments, and services.¹⁵⁹

153. Community development investment has as its primary purpose community development. Examples of qualified investments include investments, grants, or deposits or shares to: financial intermediaries (including CDFIs and CDC) that primarily lend or facilitate lending in low- and moderate-income individuals in order to promote community development; organizations engaged in affordable housing rehabilitation and construction; organizations that promote economic development by financing small businesses; facilities that promote community development in low- and moderate-income areas for low- and moderate-income individuals, such as youth programs, homeless centers, soup kitchens, health care facilities, battered women’s centers, and alcohol and drug recovery programs. *See* Interagency Questions and Answers, *supra* note 151, at 36,626.

154. 12 C.F.R. §§ 228.12(i)(1), 25.12(i)(1), 345.12(i)(1) (2005) (defining a community development service as a service that “has as its primary purpose community development”). Examples include: providing technical assistance on financial matters to small businesses and nonprofit, tribal or government organizations serving low- and moderate-income housing or economic revitalization and development needs; providing credit counseling, home-buyer, and home-maintenance counseling and financial planning. Examples of technical assistance include: serving on loan review committees, developing loan application and underwriting standards; developing loan processing systems; developing secondary market vehicles; assisting in marketing financial services; contributing accounting services. *See* Interagency Questions and Answers, *supra* note 151, at 36, 627-28.

155. *See supra* notes 118-20.

156. 12 C.F.R. §§ 228.26(a)(2), 25.26(a)(2), 345.26(a)(2) (effective Sept. 1, 2005).

157. 12 C.F.R. §§ 228.28(Appendix A)(d)(3), 25.12(Appendix A)(d)(3), 345.12(Appendix A)(d)(3) (effective Sept. 1, 2005).

158. *See supra* note 115.

159. 12 C.F.R. §§ 228.26(c), 25.26(c), 345.26(c) (effective Sept. 1, 2005). An intermediate small bank’s community development performance is evaluated based on the following criteria: the number and amount of community development loans; the number and amount of qualified investments; the extent to which the bank provides community development services; and the bank’s responsiveness through such activities to community

3. The Impact on Community Banks and Rural Populations

The purpose of the new community development test is to provide intermediate small banks with increased flexibility to meet the “substance of community needs . . . without undue regulatory consequences from the form of the response.”¹⁶⁰ The test provides greater flexibility in two ways.¹⁶¹ First, it evaluates community development activities under a single test that does not require specific allocations of community development loans, investments, and services.¹⁶² Rather, all three activities are considered together “in the context of the bank’s capacities, business strategy, the needs of the relevant community, and the number and types of opportunities for community development activities.”¹⁶³ According to the agencies, this approach permits 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.”¹⁶⁴ Second, whereas the large bank test measures “innovativeness” and “complexity,” the new regulation does not include these as criteria for community development activities.¹⁶⁵ Hence, banks have more flexibility to engage in activities that meet community needs but do not necessarily qualify as “innovative” and “complex” under the old test.¹⁶⁶

By providing a more flexible standard, the agencies “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.”¹⁶⁷ Indeed, community banks are in a good position to assess the

development lending, investment, and services needs. *Id.*

160. CRA Regulations, 70 Fed. Reg. 44,256, 44,260 (Aug. 2, 2005).

161. *See infra* notes 162-66 and accompanying text.

162. CRA Regulations, 70 Fed. Reg. at 44,261.

163. *Id.* at 44,259; *see also* Buzz Roberts, *Give Agencies a Break on CRA Effort*, AM. BANKER, June 24, 2005, at 11 (arguing that the new community development test provides flexibility, not complexity).

164. CRA Regulations, 70 Fed. Reg. at 44,259.

165. *See* Interagency Questions and Answers, *supra* note 151, at 36,633 (defining “innovativeness” and “complexity” and providing examples of such activities).

166. CRA Regulations, 70 Fed. Reg. at 44,259.

167. *Id.* at 44,260.

needs of their communities.¹⁶⁸ However, critics argue that the new regulations will eliminate the incentive for banks to engage in creative investments and to develop new financial products and services for local communities.¹⁶⁹ The likely effect of more flexibility is that banks will gravitate towards community development activities that are most profitable, carry the least amount of risk, or fall within a bank's area of expertise.¹⁷⁰ The economic reality is that banks are for-profit institutions.¹⁷¹ As noted earlier, most community banks operate under a business model that focuses heavily on relationship-based services like small business loans, small farm loans, and depository services for small customers.¹⁷² Unless this business model changes, intermediate small banks are likely to reduce non-core activities related to community development investments and services, particularly those activities considered "innovative" or "complex."¹⁷³

However, this anticipated decrease in non-core activities is likely to be insignificant for several reasons.¹⁷⁴ First, according to the agencies, the more flexible community development test is not intended "to suggest that a bank may simply ignore one or more categories of community development or arbitrarily decrease the level of such activities."¹⁷⁵ This language suggests that the agencies will still consider community investment and services in their evaluations, particularly if the bank has engaged in such activities in the past.¹⁷⁶

168. See *supra* notes 104-13 and accompanying text.

169. Mark Skertic, *Small Bank Change Seen as Threat to Poor: Loss of Loans, Services Feared*, CHICAGO TRIBUNE ONLINE EDITION, Aug. 26, 2004, <http://www.naahl.org/uploads/9599.pdf>.

170. See *infra* notes 171-73 and accompanying text; see also Letter from Karen M. Thomas, Executive Vice President, Independent Community Bankers of America (ICBA), to the FDIC, FRB, and OCC 1, 16 (May 10, 2005), available at <http://www.icba.org/files/ICBASites/PDFs/cra051005.pdf> (stating that the revised community development test "lets community banks capitalize on their strengths").

171. In 2003, bank profits in the United States totaled approximately \$153.7 billion. See Stephen Timewell, *Top 1000 World Banks*, THE BANKER, July 2, 2004, at 168, available at http://www.thebanker.com/news/fullstory.php/aid/1699/Top_1000_World_Banks.html.

172. See *supra* notes 93-113 and accompanying text.

173. See CRA Regulations, 70 Fed. Reg. 44,256, 44,259 (Aug. 2, 2005). Due to this anticipated effect, many community organizations opposed lifting the thresholds under the community development test and argued that an institution should be required to engage in community development investments and services in order to earn a "satisfactory" rating on the community development test. See, e.g., Silver, *supra* note 139, at 3.

174. See *infra* notes 175-83 and accompanying text.

175. CRA Regulations, 70 Fed. Reg. 44,256, 44,260 (Aug. 2, 2005).

176. See Silver, *supra* note 139, at 3 (arguing that the agencies' statement is "significant")

Second, because community banks provide little direct community investment to start with, any decrease would not severely impact local communities.¹⁷⁷ In fact, some supporters of the community development test argue that the new flexible criteria may actually increase investment in local communities.¹⁷⁸ Third, any intermediate small bank has the option to be evaluated under the large bank lending, investment, and service tests instead of the new community development test.¹⁷⁹ Although most banks will prefer the community development test as less burdensome than the three-part test for large banks, some institutions may opt for the status quo in order to avoid the transition costs and uncertainty of a new test.¹⁸⁰ Fourth, with regard to innovativeness and complexity factors, the agencies have made it clear that they will still “incorporate these considerations as appropriate into examination guidance and procedures to ensure flexible application of the standards.”¹⁸¹ Finally, market factors may still encourage proper investment and services.¹⁸² In other words, banks realize that certain community investments and services are profitable and would engage in these activities regardless of the CRA.¹⁸³

because “community groups can now hold the agencies accountable for enforcing their intentions of maintaining and increasing the level of community development financing by mid-size banks”).

177. See *supra* notes 99-103 and accompanying text (discussing that community banks focus primarily on lending activities rather than investment activities).

178. See Letter from Karen M. Thomas, Executive Vice President, Independent Community Bankers of America (ICBA), to the FDIC (Oct. 20, 2004), available at <http://www.icba.org/advocacy/commentlettersdetail.cfm?ItemNumber=3853&sn.ItemNumber=1711> (arguing that the old investment test forced community banks to divert resources away from their communities due to a lack of local, qualified investment options).

179. See 12 C.F.R. §§ 228.21(a)(3), 25.21(a)(3), 345.21(a)(3) (2005) (demonstrating that the agencies did not revise the provision in the old CRA regulations that permits any small bank, including an intermediate small bank, to choose to be evaluated under the large bank lending, investment, and service tests).

180. See Barr, *supra* note 129, at 4 (arguing that the new regulations might lead to high transition costs).

181. CRA Regulations, 70 Fed. Reg. 44,256, 44,260 (Aug. 2, 2005).

182. See generally Jeffrey W. Gunther, *Should CRA Stand For “Community Redundancy Act”?*, 23 REGULATION 56, available at <http://www.cato.org/pubs/regulation/regv23n3/gunther.pdf> (last visited Nov. 18, 2005) (arguing that the CRA is not necessary to ensure access to credit in low-income communities); Skertic, *supra* note 169.

183. See Gunther, *supra* note 182.

C. *The Community Development Definition*

1. The Old Regulation

Under the old regulation, “community development” includes the following four categories: 1) affordable housing, 2) community services, 3) economic development, and 4) revitalization or stabilization activities.¹⁸⁴ The first three categories target low- or moderate-income people, small farms, and small businesses.¹⁸⁵ The fourth category, revitalization or stabilization activities, targets low- or moderate-income geographic areas.¹⁸⁶

2. The New Regulation

The new regulation simply expands the fourth category, “revitalization or stabilization” activities, for all banks to include 1) designated “distressed” or “underserved” nonmetropolitan middle-income geographies,¹⁸⁷ or 2) designated “disaster” areas.¹⁸⁸ Activities that revitalize or stabilize low- or moderate-income geographies still qualify as community development activities and are eligible for CRA consideration.¹⁸⁹ In addition, the following still qualify as community development activities: affordable housing and community services for low- or moderate-income individuals, and activities that promote economic development for small businesses and small farms.¹⁹⁰

184. 12 C.F.R. §§ 228.12(g), 25.12(g), 345.12(g) (2005).

185. *Id.*

186. *Id.* Activities that “revitalize or stabilize” a low- or moderate-income geography are activities that help to attract and retain businesses and residents. Any activity that has been approved by the governing board of an Enterprise Community or Empowerment Zone or has received similar official designation by a local, state, or tribal government is presumed to revitalize or stabilize. However, examiners may also consider the actual impact on the geography. See Interagency Questions and Answers, *supra* note 151, at 36,626.

187. 12 C.F.R. §§ 228.12(g)(4)(iii), 25.12(g)(4)(iii), 345.12(g)(4)(iii) (effective Sept. 1, 2005).

188. 12 C.F.R. §§ 228.12(g)(4)(ii), 25.12(g)(4)(ii), 345.12(g)(4)(ii) (effective Sept. 1, 2005).

189. 12 C.F.R. §§ 228.12(g)(4)(i), 25.12(g)(4)(i), 345.12(g)(4)(i) (effective Sept. 1, 2005).

190. 12 C.F.R. §§ 228.12(g), 25.12(g), 345.12(g) (effective Sept. 1, 2005).

A nonmetropolitan, middle-income area is distressed if it is in a county that meets one or more of the following criteria: 1) an unemployment rate of at least 1.5 times the national average, 2) a poverty rate of twenty percent or more, or 3) a population loss of ten percent or more between the previous and most recent decennial census or a net migration loss of five percent or more over the five-year period preceding the most recent census.¹⁹¹ The agencies publish a list of CRA-eligible rural areas that are distressed on the website of the Federal Financial Institutions Examination Council (“FFIEC”).¹⁹² Activities that qualify for community development consideration within distressed areas, like in low- or moderate-income areas, are “based on the regulation and applicable interagency guidance.”¹⁹³

A nonmetropolitan, middle-income area is underserved if it meets criteria for population size, density, and dispersion that “indicate the area’s population is sufficiently small, thin, and distant from a population center that the tract is likely to have difficulty financing the fixed costs of meeting essential community needs.”¹⁹⁴ The agencies use “urban influence codes” maintained by the Economic Research Service (“ERS”) of the United States Department of Agriculture to determine the underserved designations.¹⁹⁵ Like distressed areas, the underserved areas are listed on the FFIEC website.¹⁹⁶ The following activities qualify as revitalizing and stabilizing underserved areas assuming that low- or moderate-income individuals are served: bank financing for construction, expansion, improvement, maintenance, or operation of

191. 12 C.F.R. § 1805.201(b)(3) (2005). The agencies have adopted these criteria from the CDFI Fund. The CDFI Fund uses other criteria which have not been adopted by the agencies in the CRA regulation’s definition of community development. *See* CRA Regulations, 70 Fed. Reg. 44,256, 44,262 (Aug. 2, 2005).

192. *See* FFIEC, 2005 List of Middle-Income Nonmetropolitan Distressed or Underserved Geographies (updated Nov. 30, 2005), <http://www.ffiec.gov/cra/pdf/distressedorunderservedtracts.pdf>.

193. CRA Regulations, 70 Fed. Reg. 44,256, 44,262 (Aug. 2, 2005); *see also supra* notes 150-55 and accompanying text (discussing interagency guidance for community development activities in low- or moderate-income areas).

194. CRA Regulations, 70 Fed. Reg. at 44,262; *see* 12 C.F.R. §§ 228.12(g)(4)(iii)(B), 25.12(g)(4)(iii)(B), 345.12(g)(4)(iii)(B) (effective Sept. 1, 2005).

195. FFIEC, CRA Examinations, <http://www.ffiec.gov/cra/examinations.htm> (last visited Jan. 5, 2006); *see also* ERS, U.S. DEP’T OF AGRICULTURE, <http://www.ers.usda.gov/Briefing/Rurality/urbaninf/> (last visited Nov. 18, 2005) (defining “urban influence codes”).

196. *See supra* note 192.

essential infrastructure or facilities for health services, education, public safety, public services, industrial parks, or affordable housing.¹⁹⁷

Disaster areas are designated by Federal or State Governments.¹⁹⁸ For example, Major Disaster Declarations administered by the Federal Emergency Management Agency (“FEMA”) would result in the designation of CRA-eligible disaster areas.¹⁹⁹ A disaster area designation will expire for purposes of CRA eligibility when it is no longer in effect according to the law under which it was declared.²⁰⁰ Revitalization activities that benefit low- or moderate-income individuals in disaster areas are given “significant weight” by agencies in a CRA evaluation.²⁰¹

3. The Impact on Community Banks and Rural Populations

According to the agencies, the purpose of this change is to “increase the number and kinds of rural tracts in which bank activities are eligible for community development consideration.”²⁰² Historically, there has been both a relative and absolute scarcity of CRA-eligible rural tracts.²⁰³ For example, in 2003, fifty-nine percent of rural counties did not include any tracts that were classified as low-income.²⁰⁴ This percentage is compared to only eighteen percent of urban counties that did not include low-income tracts.²⁰⁵ Furthermore, only fifteen percent of rural tracts qualified as low- or moderate-income tracts in 2003.²⁰⁶

A scarcity of lower-income tracts appears to “limit the effectiveness of the regulations in encouraging rural community development.”²⁰⁷ Banking institutions might shift more resources to

197. CRA Regulations, 70 Fed. Reg. at 44,262.

198. *Id.* For example, in response to Hurricane Katrina, FEMA designated several counties in Alabama, Florida, Louisiana, and Mississippi as disaster areas. Under the new CRA regulations, these counties would be eligible for CRA revitalization and stabilization activities. See FEMA, <http://www.fema.gov/news/disasters.fema?year=2005> (last visited Nov. 18, 2005) (providing a full list of declared disaster areas for 2005).

199. CRA Regulations, 70 Fed. Reg. 44,256, 44,262 (Aug. 2, 2005).

200. *Id.*

201. *Id.*

202. *Id.* at 44,261.

203. *Id.* at 44,260, n. 11.

204. *Id.*

205. *Id.*

206. *Id.*

207. CRA Regulations, 70 Fed. Reg. 44,256, 44,260 (Aug. 2, 2005).

urban areas that have a higher percentage of low-income tracts.²⁰⁸ In addition, banks “might receive inadequate recognition of their community-improving activities in rural areas because the activities did not meet the exact requirements to qualify as community development.”²⁰⁹ Thus, banks might invest less, or less effectively, in rural areas, due to the scarcity of low-income tracts.²¹⁰

The new expanded definition of community development will substantially increase the number of rural tracts that are CRA-eligible, thereby encouraging more investment in rural communities.²¹¹ According to one study, just adding the “distressed” category alone would increase the percentage of rural tracts that qualify as low-income from fifteen percent to thirty-three percent.²¹² In addition, it would increase the percentage of rural counties with at least one rural tract from forty-nine percent to approximately fifty-five percent.²¹³ This particular study did not consider the effect on the underserved and disaster area categories.²¹⁴ If these categories are also taken into account, the increase in CRA-eligible rural tracts is likely to be even greater than the percentages listed above.²¹⁵ By increasing the number of CRA-eligible rural tracts, the agencies increase the opportunity and incentive for banks to invest in their local communities and designated rural areas.

VI. THE OTS REVISIONS AND THEIR IMPACT

As noted earlier, the OTS issued new CRA regulations separate from the revisions adopted by the OCC, the FRB, and the FDIC.²¹⁶ Like

208. See Avery et al., *supra* note 54, at 218-19.

209. *Id.* at 219.

210. *Id.* at 218-19.

211. *Id.* at 224.

212. *Id.* at 225.

213. *Id.*

214. *Id.* The study only considered “distressed” areas. *Id.*

215. In Alabama, for example, three rural counties qualify as underserved but do not meet the distressed criteria. See FFIEC, 2005 List of Middle-Income Nonmetropolitan Distressed or Underserved Geographies (updated Nov. 30, 2005), <http://www.ffiec.gov/cra/pdf/distressedorunderservedtracts.pdf>.

216. See *supra* note 66 and accompanying text. Although Section 303 of the Riegle Community Development and Regulatory Improvement Act of 1994 (12 U.S.C. § 4803) directs banks to work jointly to make uniform all regulations and guidelines implementing common statutory or supervisor policies, the OTS contends that its non-uniform regulation

the other agencies, the OTS raised the threshold for small thrifts from \$250 million to \$1 billion in assets, thereby eliminating the data collection and reporting obligations for all thrifts with assets under \$1 billion.²¹⁷ Unlike the other agencies, however, the OTS did not adopt the new community development test to replace the investment and service tests applied to large thrifts.²¹⁸ The small thrift CRA evaluation consists only of a streamlined lending test and does not require community development investment and service activities.²¹⁹ The purpose of the OTS revisions is to “reduce the existing CRA examination and reporting burden on the affected savings associations in order for these institutions to be able to dedicate scarce resources to better meet the credit needs of their local communities.”²²⁰

Under the new regulation, approximately eighty-eight percent of all federal thrifts will be evaluated as small thrifts.²²¹ Critics argue that the OTS revisions will result in a decrease in community development investments and services because these activities are no longer considered in the small thrift evaluation.²²² Moreover, critics argue that the elimination of the data collection and reporting requirements will also decrease lending activity due to less public accountability.²²³ The OTS, on the other hand, contends that there will not be a significant decrease in such activities for several reasons.²²⁴ First, an overwhelming majority of total thrift assets will remain covered by the large institution test.²²⁵ Second, small business and small farm lending constitute a very minor part of the overall business of thrifts with assets

is permitted by law. See CRA Regulations, 69 Fed. Reg. 51,155, 51,159 (Aug. 18, 2004) (citing examples of non-uniform regulations adopted by the four agencies).

217. See 12 C.F.R. § 563e.12(t) (2005). Under the new regulation, small thrifts are not required to collect and report CRA data related to small business, small farm, and community development loans. *Id.*

218. See 12 C.F.R. § 563e.26 (2005) (listing the performance criteria for small savings associations, which are focused on lending and do not include a community development test similar to that adopted by the other agencies).

219. *Id.* Cf. 12 C.F.R. § 563e.22 (2005) (listing the more extensive performance criteria for the lending test for large thrifts, as compared to the streamlined test for small thrifts).

220. CRA Regulations, 69 Fed. Reg. 51,155, 51,157 (Aug. 18, 2004).

221. See BROOME & MARKHAM, *supra* note 135, at 455.

222. See, e.g., Taylor, *supra* note 142, at 10.

223. *Id.*

224. See *infra* notes 225-29 and accompanying text.

225. See CRA Regulations, 69 Fed. Reg. at 51,158. In 1995, 87.9% of total thrift industry assets were covered by the large institution test. Under the new regulation, 86.4% of thrift industry assets will be covered under the large institution test. *Id.*

under \$1 billion.²²⁶ Therefore, eliminating the data collection and reporting requirements for these lending activities is not likely to have a significant impact.²²⁷ Third, upon a thrift's request, OTS will consider community development investments and services for purposes of raising a small thrift's performance rating.²²⁸ Therefore, small thrifts may still have some incentive to engage in investments and services in order to achieve higher CRA ratings.²²⁹

The non-uniformity of the new regulations between the agencies may have more significant effects. First, the non-uniformity may provide an incentive for small banks to switch to a thrift or savings bank charter in order to benefit from the more streamlined test. Second, the OTS's decision to act unilaterally creates uncertainty as to how all four agencies will implement the CRA in the future. By strengthening the precedent of non-uniformity, the new regulations may also reduce cooperation between the agencies in other regulatory areas beyond the CRA.

VII. CONCLUSION

The most recent revisions to the CRA regulations will benefit community banks and their customers by reducing the costs of CRA compliance.²³⁰ Community banks such as Delta Southern Bank, which provided the funding to E.V. Wilson to open his family business One Stop, can continue to grow in assets up to \$1 billion without incurring additional costs related to CRA data collection and reporting obligations.²³¹ In addition, the revisions are likely to benefit rural areas that did not qualify for CRA-related activities under the old regulation but do qualify under the new regulation as designated distressed,

226. *Id.* In 2003, thrifts under \$1 billion in assets contributed only 0.5% (by number of loans) and 2.2% (by amount of loans) of the total small business loans originated or reported by all banks and thrifts combined. They accounted for only 1.2% (by number of loans) and 1.5% (by amount of loans) of the total small farm loans. *Id.*

227. *Id.* ("By raising the asset threshold, the burden associated with reporting requirements for loans that constitute a minor part of the overall business of small thrifts will be relieved without significant impact to the CRA data collection as a whole and the benefits derived from such data."). Moreover, the mortgage-related loans made by thrifts are reported under the HMDA. *Id.*

228. See CRA Regulations, 69 Fed. Reg. 51,155, 51,159 (Aug. 18, 2004).

229. *Id.*

230. See *supra* notes 129-38 and accompanying text.

231. See *supra* notes 6-7, 122-38 and accompanying text.

underserved, or disaster areas.²³² Although some rural areas may realize a decrease in CRA-related community investment and services under the new regulation, such an impact is likely to be insignificant.²³³

Beyond small community banks, the biggest potential winners may be large banks.²³⁴ If the new regulations prove successful, large banks will lobby hard for the changes to apply to them.²³⁵ Such changes would result in substantial regulatory relief for large banks.²³⁶ Although the agencies have refused to enact such a change in this instance, it is likely to be a serious consideration when the CRA regulations are revisited in the future.²³⁷

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232. See *supra* notes 187-215 and accompanying text.

233. *Id.*

234. See *infra* notes 235-36 and accompanying text.

235. The lobbying has already begun, with large banks arguing that the new regulations create a competitive imbalance between small and large banks. See Hannah Bergman, *CRA Changes are Unfair, Big Banks Tell Regulators*, AM. BANKER, May 5, 2005, at 4.

236. *Id.*

237. *Id.*; see also CRA Regulations, 70 Fed. Reg. 44,256, 44,259 (Aug. 2, 2005) (rejecting recommendations by large banks to have the data reporting exemptions and streamlined lending test and community development test applied to them).

