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Who Needs Assessment Areas, Anyway?

Tips for Establishing and Maintaining an Effective Assessment Area for Purposes of the Community Reinvestment Act

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Approximately four years ago, the federal financial supervisory agencies[1] jointly revised their regulations that implement CRA. These revisions were enacted to enable regulators to make more performance-based assessments of financial institutions, relative to CRA. By now, most Third District financial institutions have been assessed at least once under the one of the four revised methodologies—small institutions, large retail institutions, limited purpose or wholesale institutions, and institutions with strategic plans.

Our office occasionally receives inquiries from representatives of Third District state member banks regarding the delineation of an assessment area. Furthermore, our recent experience in assessing CRA performance of state member banks in the Third District suggests that the delineation of an assessment area may still pose a challenge for some institutions. This article provides tips on the essential framework and key concepts to consider when delineating or modifying an assessment area.

Essential Framework of Assessment Area Delineation

All financial institutions subject to CRA must delineate one or more assessment areas, as applicable. Banks can, and in some cases must, have multiple assessment areas, as discussed more below.

All institutions must delineate an assessment area that generally consists of one or more Metropolitan Statistical Areas (MSAs) or one or more contiguous political subdivisions, such as counties, cities, or towns that contain a bank's main office, branch offices, and deposit-taking automated teller machines (ATMs).

Institutions, other than wholesale or limited-purpose banks, must also include in their assessment area(s) the geographies (e.g., census tracts or block numbering areas (BNAs), as designated by the U.S. Census Bureau) that contain a bank's main office, branch offices, and deposit-taking ATMs, and also those geographies in which a bank has originated or purchased a *substantial portion* of its loans.

In addition, the assessment area(s) for **all institutions** must:

- Consist only of whole geographies (e.g., an institution cannot designate only part of a census tract or BNA)
- Not reflect illegal discrimination or "redlining"
- Not arbitrarily exclude low- or moderate-income geographies, taking into account an institution's size and financial condition
- Not extend "substantially" beyond a Consolidated Metropolitan Statistical Area (CMSA) boundary,

[1] The Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision

or a state boundary, unless the assessment area is located in a multi-state MSA. In this same regard, an assessment area must not extend substantially beyond an MSA, if the MSA is not located in, or part of, a CMSA.

Key Concepts in Assessment Area Delineation

The following key concepts should be kept in mind when actually delineating, modifying, or expanding a bank's assessment area.

The implementing regulations for the Community Reinvestment Act encourage financial institutions to "be inclusive" with respect to delineating assessment areas. This means that institutions should establish assessment area boundaries that coincide with the boundaries of one or more MSAs or one or more contiguous political subdivisions, such as counties, cities, or towns.

An institution may adjust the boundaries of an assessment area to include only an area that it "reasonably" can be expected to serve.

Notwithstanding such encouragement, the regulations permit an institution to adjust the boundaries of an assessment area to include only a portion of a political subdivision that it "reasonably" can be expected to serve. This provision provides institutions some flexibility in drawing their assessment areas, particularly with respect to an area that would otherwise be extremely large, of unusual configuration, or divided by significant geographic barriers, like a major highway or interstate route, mountain range, or river.

In making any adjustments to the boundaries of assessment areas, institutions *must not* arbitrarily exclude low- and moderate-income geographies. Examiners will determine, on a case-by-case basis, whether or not an institution has arbitrarily excluded low- or moderate-income geographies from its assessment areas, considering relevant facts. This analysis will generally include the following considerations:

- Income levels in an institution's assessment area(s) and surrounding geographies;
- The location(s) of an institution's branches and deposit-taking ATMs:
- Loan distribution in the institution's assessment area(s) and surrounding geographies:
- The institution's size;
- The institution's financial condition; and,
- The institution's business strategy, corporate structure, and product offerings.

Additionally, it is important to note that the implementing regulations *permit*, but do not *require*, an institution to adjust the boundaries of an assessment area. Let's assume for example that an institution delineates the entire county in which its offices are located, but could have delineated only a portion of the county. Under the lending test of the CRA assessment methodology, the bank would not be penalized for only lending in that portion of the county that it could have delineated as the assessment area, provided that portion does not arbitrarily exclude any low- or moderate-income geographies, or reflect any illegal redlining, or prohibited credit discrimination.

Although, from a regulatory standpoint, financial institutions are encouraged to be inclusive in delineating assessment areas, an assessment area *cannot* extend substantially beyond the boundaries of a CMSA (or an MSA, if the MSA is not included in or part of a CMSA). Stated another way, an institution must delineate as separate assessment areas those areas outside a CMSA (or an MSA, if the MSA is not located in a CMSA) that extend substantially beyond the CMSA (or MSA, as applicable). In this regard, the Third Federal Reserve District contains 17 MSA's but only one CMSA, the Philadelphia/Wilmington/Atlantic City CMSA. This CMSA is in turn comprised of four MSAs—the Philadelphia MSA, the Atlantic City/Cape May MSA, the Vineland/Millville/Bridgeton MSA, and the Wilmington/Newark MSA. Hence, Third District institutions should bear this in mind in delineating any assessment area(s) that are located in or involve MSAs not included in this CMSA.

Affect of Delineation on Examination Findings

The current assessment methodology focuses upon an institution's distribution and level of lending, investments, and services, rather than on "how" or "why" an institution delineated its assessment area or "local community." Accordingly, if an assessment area fails to comply with the criteria outlined in the overview presented in this article (refer also to section 228.41of the Federal Reserve System's Regulation BB), examiners will not penalize an institution in assessing its CRA performance.

Instead, after discussions with management, examiners would establish a revised or more relevant assessment area(s) and utilize it to evaluate performance under CRA. Other than an assessment area reflecting prohibited redlining or disparate treatment in the extension of credit, examiners would not consider such a revision in an institution's CRA rating, nor discuss it in the written CRA performance evaluation that is publicly disclosed. However, examiners generally would mention such a revision in the written report of examination that is made available only to an institution's directorate and management, and may cite any violation(s) of section 228.41 of Regulation BB (or other implementing regulations) in the report of examination.

If you have any questions regarding the delineation of CRA assessment areas, please contact Robert Snarr at (215) 574-3460 or e-mail at robert.snarr@phil.frb.org. Also, stay tuned for additional guidance from the federal agencies regarding out-of-assessment area activities and delineating assessment areas when offering electronic banking, which should be issued for public comment later this year. ■