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COVID-19's Unexpected Effects on Community Reinvestment Act Compliance for Banks

The COVID-19 pandemic continues to impact the banking industry in both expected and unexpected ways. Many have already commented upon the pandemic's influence on consumer behavior, specifically the noted decrease in consumer spending and the increase in consumer savings. Because of that macroeconomic change, many U.S. banks have seen an increase in deposits and a corresponding decrease in consumer lending balances. Banks are already well along in evaluating the impact of increased deposits upon their liquidity, earnings, and capital positions. But what is too often overlooked are the consequences that those pandemic-driven changes, specifically the trending increase in deposits, will have on the bank's Community Reinvestment Act (CRA) ratings.

CRA Evaluations

The CRA requires that banks be evaluated on meeting the needs of the communities it serves. The evaluations differ procedurally based on the asset size of the financial institution, and the evaluation process is segregated into a small bank, intermediate small bank, or large bank test.^[1] The results of these CRA evaluations are publicly available.

The CRA evaluation standards are different depending upon asset size. Recent updates and modifications to the CRA rules have resulted in variances among regulatory authorities on the asset size that determines whether a bank is to be evaluated under a small bank, intermediate small bank, or the large bank test. Under the CRA rules, an FDIC or a Federal Reserve regulated entity is defined as a small or intermediate small bank if it has assets of less than \$1.322 billion,^[2] and under the OCC issued rules those banks under \$2.5 billion^[3] are small or intermediate small banks. For these small or intermediate small banks, the evaluation procedures under the lending test include a determination of whether the loan to deposit

ratio exhibit an effective use of depositor funds being reinvested into the community. This loan to deposit ratio element is not an element of a large bank's lending test.

A recent review of the past seven quarters of publicly released CRA Performance Evaluations for small or intermediate small banks indicate that where a bank fails to maintain a reasonable loan to deposit ratio can be a significant contributing factor to that bank receive unsatisfactory ratings in the lending test. The unsatisfactory rating in the lending test will generally result in the bank receiving an overall rating of "Needs to Improve." Can we expect an upward trend of poor CRA performance ratings with the current record deposits currently held by financial institutions?

Context, Context, Context

An important part of the CRA evaluation is for a financial institution to explain the context of the bank's performance under the CRA to the evaluators. Small and intermediate small banks are tasked with maintaining the loan to deposit ratio as part of its public file. Consequentially, if your bank is witnessing a downward trend in the loan to deposit ratio as documented in your public file, consider taking the time to document your performance context in relation to the loan deposit ratio.

According to the regulators, "[t]he performance context is a broad range of economic, demographic, and institution – and community-specific information that an examiner reviews to understand the context in which an institution's record of performance should be evaluated."^[4] Performance context contemplated by the CRA regulations include demographic data, relevant data of the assessment area(s), the bank's product offerings and business strategy, institutional capacity and constraints, any other factors that significantly affect the bank's ability to lend, or any other information deemed relevant.^[5]

If there are relevant current economic or community factors that are contributing to the decline in loans relevant to deposits, determine and document these factors now.

For more information, please contact [Nancy Presnell](#) or any attorney with Frost Brown Todd's [Financial Services](#) industry team.

[1] Additional procedural evaluations may also be conditioned on whether the financial institution is a Wholesale Bank, Special Purpose Bank or has submitted and had approved a CRA Strategic Plan.

[2] 12 C.F.R. 228.12. 12 C.F.R. 328.12. Effective January 1, 2021.

[3] OCC News Release 2020-63, "OCC Finalizes Rule to Strengthen and Modernize Community Reinvestment Act Regulations."

[4] Community Reinvestment Act: Interagency Questions and Answers Regarding Community Reinvestment.

[5] 12 C.F.R. 228.21(b).

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