



In May 2018, the Department of Justice (DOJ) reached a settlement with KleinBank regarding a Redlining-related lawsuit filed by the DOJ against the bank in January 2017. In the lawsuit, the DOJ alleged the bank “engaged in unlawful redlining of majority-minority neighborhoods in the Minneapolis-St. Paul metropolitan area” from 2010 through 2015. The DOJ found that KleinBank’s lending activity showed that the Bank was significantly less likely to receive applications from and originate loans in minority communities than comparable peers.

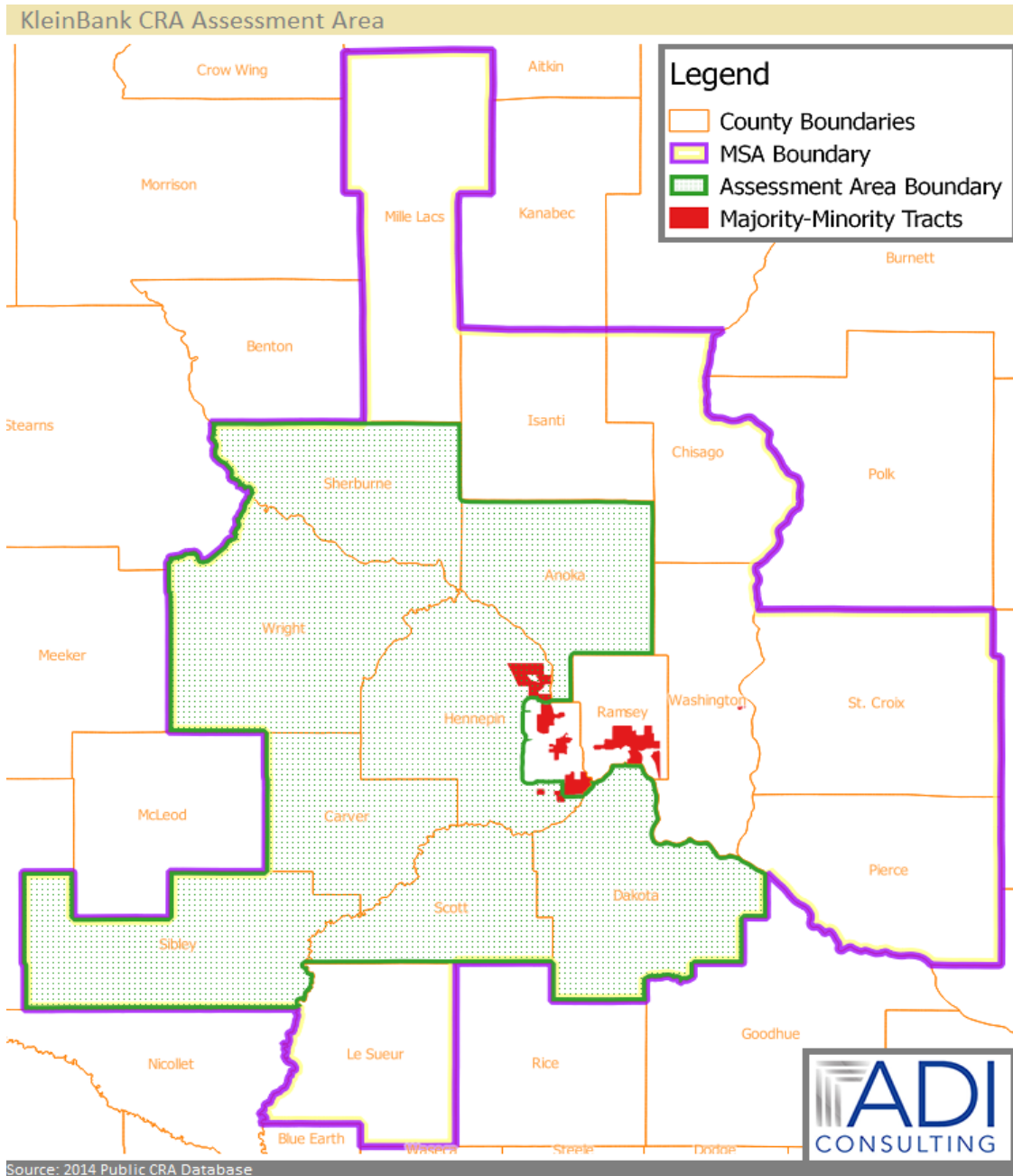
The DOJ concluded that the bank’s lending activity was driven by practices that included, among other factors, the bank’s avoidance of majority-minority census tracts from its delineated assessment area as required under the Community Reinvestment Act (CRA). What makes this lawsuit and resulting settlement notable, is that they follow closely behind BancorpSouth’s Redlining settlement in 2016, where the DOJ made similar findings regarding the relationship between Redlining and CRA assessment area delineations.

These events should serve as a notice to bank leaders that the decisions made regarding their CRA assessment areas can become critical evidence for regulators and the DOJ as they evaluate potential Redlining concerns. Lending activity showing low penetration in majority-minority communities may present risk of disparate impact; however, assessment areas that arbitrarily avoid majority-minority communities can strengthen an argument that a bank is actively avoiding minority neighborhoods. Ensuring an appropriate CRA assessment area delineation is an important component of a holistic compliance management program.

KleinBank’s Assessment Area Problem

The assessment area is a critical concept for CRA compliance. CRA Performance Tests are measured largely on how CRA-covered financial institutions perform in their assessment areas, and the institutions are responsible for delineating their assessment areas while meeting the technical requirements set forth by the Federal Reserve Board. Among these requirements, one where regulators have discretion in its interpretation and enforcement is that the assessment area delineation should not reflect illegal discrimination or arbitrarily exclude low- or moderate-income (LMI) and majority-minority geographies. This requirement is a source of the issues identified for KleinBank’s assessment area.

To investigators, a map of the problematic assessment area illustrated how the bank arbitrarily avoided large clusters of majority-minority communities within the metropolitan area. As demonstrated in the figure below, the selection of a portion of one county and the exclusion of an entire county with significant concentrations of minorities resulted in an unusually-shaped assessment area that supported a perception that the bank actively avoided providing credit to minority neighborhoods.



A comparison of KleinBank’s assessment area and MSA boundaries.

Notably, BancorpSouth also had an [unusually-shaped assessment area](#) (see Exhibit A) that encircled large clusters of minority communities. Yet both institutions received “Satisfactory” ratings based on these assessment areas in their respective CRA Performance Evaluations prior to the lawsuits.



Complacency Produces Risk

In our work for clients, ADI has reviewed hundreds of CRA Performance Evaluations to understand the factors that drive examiner ratings for each criteria and CRA Performance Test. Very rarely do examiners document concerns about assessment area delineations. When an assessment area issue is mentioned, examiners typically evaluate CRA performance under their modified assessment area. Otherwise, examiners will raise any concerns and make recommendations on assessment area changes in direct communications with the examined bank. In these instances, bank leaders may adopt the recommended changes or make a case for why the existing delineation is appropriate.

A primary reason for few findings related to assessment areas in CRA examinations is that assessment area delineations are not a CRA performance factor. Delineations are reviewed for reasonableness in meeting the technical requirements, and recommendations of changes may be offered (sometimes strongly). However, in our experience, examiners rarely modify a bank's existing assessment area to conduct their examination. This leads many bank leaders to place a low priority on assessment area delineations relative to other compliance matters. Assessment areas may not be actively reviewed and could remain unchanged for many years.

Even though it is not a CRA performance factor, a poorly-defined assessment area may negatively affect CRA performance factors – such as the Inside-Outside ratio and the distribution of lending activity – that can present substantial risk of achieving satisfactory CRA performance. In addition, the assessment area provides a critical nexus between CRA and Redlining risk. A bank may be relatively safe in its assessment area delineation under the requirements of CRA, but assessment area decisions can be used against the bank to support a finding of Redlining discrimination. The BancorpSouth Redlining case offers a useful example of this paradigm.

An Assessment Area May Be Okay Before It Isn't

Prior to the BancorpSouth Redlining lawsuit, CRA examiners accepted the Bank's assessment area delineations without modifications and gave the Bank a "Satisfactory" overall rating in its Performance Evaluations. In the Bank's most recent examination in 2010, prior to the lawsuit, examiners acknowledged the Bank's selection of only portions of some counties in the Memphis, TN-MS-AR Metropolitan Service Area (MSA), but did not suggest this was a concern.

While there may have been communications between bank officials and examiners outside of the Performance Evaluation regarding the assessment area, bank leaders did not make any changes to the assessment area until 2013 due to Redlining issues. By that point, regulators used the Bank's Memphis assessment area delineation as a critical piece of a larger narrative that it discriminated against majority-minority communities. This finding of Redlining discrimination, in turn, led to a downgrade in BancorpSouth's subsequent Performance Evaluation to a "Needs to Improve" rating and an expedited second CRA examination a year later.



We may see this same pattern for KleinBank, as its most recent Performance Evaluation occurred before the Redlining lawsuit. In that Performance Evaluation, CRA examiners acknowledged the selection of portions of counties in the Minneapolis-St. Paul-Bloomington, MN-WI MSA and evaluated it based on that delineation, giving KleinBank a “Satisfactory” overall rating. As with BancorpSouth, the subsequent finding of Redlining discrimination may yield a ratings downgrade in the Bank’s next Performance Evaluation and an accelerated examination cycle.

What Banks Should Do

As argued earlier, bank leaders should take notice of the implications from the KleinBank and earlier BancorpSouth Redlining cases. With assessment area delineations serving as crucial pieces of evidence supporting those lawsuits, ADI offers the following three recommendations to address Redlining risk.

Recommendation 1: Watch Out for Red Flags

The facts of the KleinBank and BancorpSouth cases indicate that assessment area problems are more likely to arise when a bank – in particular, a large- or intermediate-sized bank – selects one or more partial counties (i.e., one or more census tract located in the county is excluded) within a metropolitan area for assessment areas. Selecting whole counties (i.e., all census tracts in the county) may reduce a bank’s risk related to assessment areas, while selecting an entire MSA will minimize the exposure to Redlining risk from assessment area decisions.

Without assessment area delineations that can be reasonably perceived as avoiding majority-minority communities, there is one less piece of evidence that can be used to make a case of Redlining discrimination. If a partial county is selected for an assessment area, bank leaders must be prepared to defend the delineation based on legitimate, non-prohibited basis factors.

Recommendation 2: Frequently Review Assessment Area Delineations

With the exception of branch openings and/or closings, it is very common for assessment area delineations to remain unchanged for many years. Such static delineations may be perfectly reasonable; however, it would be prudent to incorporate a periodic review of assessment area delineations as a component of a CRA compliance management program, to confirm that the technical requirements are met.

ADI recommends an annual review of assessment area delineations following yearly updates of minority and income demographic data. These reviews help ensure that a bank’s assessment area continues to meet technical requirements while making bank leaders aware of potential implications that changing demographics may have on satisfying those requirements. Moreover, periodic reviews will demonstrate to regulators that the institution is proactive and earnest in complying with CRA regulations and preventing Redlining discrimination.



Recommendation 3: Know Your REMAs

So far, this article has focused on how assessment area delineations can be interpreted as evidencing Redlining discrimination. It is also important to know that regulators are not limited to considering lending performance only in assessment areas during Redlining investigations. Such investigations are based on how regulators define an institution's Reasonably Expected Market Area (REMA).

An REMA is intended to represent the geographic area in which an institution actually marketed and provided credit. Often, this area is larger than or otherwise different from the delineated CRA assessment area. If bank leaders are focused only on performance within their CRA assessment area(s), they may be surprised by findings from lending activity beyond those boundaries.

ADI recommends that bank leaders review the geographic distribution of their lending activity and marketing activities to identify REMAs for evaluating Redlining risk. Though regulators themselves will determine the REMAs to be used for their examinations, they will accept input from banks in making those determinations. Moreover, analyzing performance within the REMAs, rather than just the assessment areas, will allow leaders to anticipate and address problematic lending activity.

Applying Lessons from KleinBank

Assessment area delineations generally do not affect CRA examinations in a negative manner; however, these decisions matter beyond CRA regulation requirements. After all, CRA was created to address Redlining discrimination. Evidence indicates regulators are using these decisions in their investigations of this form of discrimination. At ADI, we analyze cases such as KleinBank and BancorpSouth for lessons like those described in this article that can be applied to our client solutions. We encourage you to evaluate your compliance management system for opportunities to address the issues that such cases highlight – before your examiners do.