

BY KAREN TUCKER, NBE,
AND CALVIN R. HAGINS,
CRCM, CRP, AMLP

ACCORDING TO NEWS REPORTS, THE ECONOMY IS IN RECESSION, foreclosures are up, and business results are down. And yet, in the midst of the current economic climate, regulators continue to expect banks to comply with the Community Reinvestment Act (CRA). Why?

CRA is a fundamental aspect of banking. Banks continue to have an obligation to help meet the credit needs of their communities, consistent with safe and sound banking practices. In fact, in the current economic climate, credit and community development needs may have intensified in a bank's assessment area. Creditworthy borrowers like individuals, small businesses, and small farms continue to need credit. Individuals and families need access to financial services. Nonprofit and community organizations need access to funding and services.

Fortunately, the CRA regulation can and does accommodate changes in economic conditions. Each bank's unique performance context, including economic conditions, is part of its CRA evaluation. Regulators must consider how a bank is helping to meet credit needs in light of its capacity and constraints. Bankers should take the opportunity to discuss with their regulators how the current economic climate has affected their bank's capacity and constraints, and thereby its ability to help meet credit needs. Regulators, in turn, will continue to follow the CRA examination procedures and thoughtfully evaluate the bank's CRA performance.

What then are the most pressing questions and concerns about CRA today? How can banks ensure a continued strong lending test performance? What types of investments are available now? Are there any new community development services opportunities? And finally, what do examiners really expect?

This article covers some common issues and questions related to ensuring good CRA performance in the current economic environment for all three parts of the large-bank CRA examination: lending, investments, and services. However, it's not intended to cover every issue a bank may face during these times, and you should contact your primary regulator if needed.

Lending Test Issues

A bank should continue to make credit available to creditworthy borrowers, consistent with safe and sound banking practices and the bank's capacity and operating constraints. However, some banks' capacity to meet credit needs has changed. Credit needs in some assessment areas have also changed.

While credit needs vary from community to community, there are some lending activities that are likely to be responsive in helping to meet the credit needs of many communities, particularly in the current economic climate. Here are two examples of activities that could be discussed as part of the qualitative assessment of a bank's lending performance:

- establishing loan programs with the objective of providing affordable, sustainable, long-term relief—for example through loan refinancings, restructurings, or modifications—to homeowners who are facing foreclosure on their primary residences
- establishing loan programs that transition low- and moderate-income borrowers from higher-cost loans to lower-cost loans provided the loans are made in a safe and sound manner



A DELICATE



**Managing CRA
in the Current
Economic
Climate**

BALANCE

**Bankers should take the opportunity
to discuss with their regulators
how the current economic climate
has affected their bank's capacity and constraints,
and thereby its ability
to help meet credit needs.**

How is a home loan modification viewed under the CRA lending test?

Although home loan modifications are not considered originations or purchases of loans, financial institutions may receive positive CRA consideration for providing them.¹ The OCC encourages banks to work constructively with residential borrowers who are financially unable to make their contractual payment obligations on their home loans. Prudent workout arrangements that are consistent with safe and sound lending practices are generally in the long-term interest of both the financial institution and the borrower.

Banks may provide data about home loan modifications as “other loan data” for consideration under the lending test.² Other loan data also includes the following:

- MECAs—or home mortgage loan modification, extension, and consolidation agreements—in which a bank obtains home mortgage loans from other institutions without actually purchasing or refinancing the home mortgage loans, as those terms have been interpreted under CRA and HMDA (In some states, MECAs may achieve the same results as purchases or refinancings.³)
- loans funded for sale to the secondary markets that an institution has not reported under HMDA
- unfunded loan commitments and letters of credit
- commercial and consumer leases
- loans secured by nonfarm residential real estate, not taken as an abundance of caution, that are used to finance small businesses or small farms and that are not reported as small business, small farm, or HMDA loans
- loans that do not have a primary purpose of community development, but where a certain number or percentage of units is set aside for affordable housing
- an increase to a small business or small farm line of credit if the increase would cause the total line of credit to exceed \$1 million in the case of a small business line, or \$500,000 in the case of a small farm line

In addition to qualitative consideration for activities that are considered responsive to local credit

needs, what other needs and opportunities are available for lending test consideration?

- Loans for rental housing, including single-family housing, for people of all income levels
- Community development loans to finance affordable rental housing for low- and moderate-income tenants
- Consumer loans, for which banks exercise their option to collect and maintain loan data and request lending test consideration
- Loans originated or purchased by consortia in which the bank participates or by third parties in which the bank has invested if these loans meet the definition of community development loans and if the bank reports loan data in accordance with the requirements of the CRA regulation

How do the agencies characterize responsible lending to low- and moderate-income individuals?

- A responsible mortgage lending product geared to low- and moderate-income individuals should contain four key elements:
 1. The product should be understandable and have disclosures that convey key elements of the transaction to the consumer.
 2. Lenders should qualify borrowers based not just on their capacity at the initiation of the transaction but over the life of the loan, using the fully indexed interest rate.
 3. Borrowers should have some equity in the transaction and be required to make a down payment using their own funds.
 4. The credit underwriting analysis should be flexible enough to evaluate “thin file” borrowers who can demonstrate their ability to repay recurring non-credit-related obligations in a timely manner.⁴
- The OCC supports the efforts being pursued by the FDIC and the President’s Advisory Council on Financial Literacy to ensure that mortgage products remain available to Americans of all income levels with the desire and capacity to become homeowners. Consumers can get additional information from the U.S. Financial Literacy and Education Commission (www.mymoney.gov).

Will institutions receive favorable CRA consideration for foreclosure prevention activities conducted in low- or moderate-income geographies?

Activities that may be considered to help revitalize or stabilize low- or moderate-income areas include foreclosure prevention programs with the objective of providing affordable, sustainable, long-term loan restructurings or modifications to homeowners in low- or moderate-income geographies, consistent with safe and sound banking practices, that may help to revitalize or stabilize those geographies. Examiners must consider the actual impact on the low- or moderate-income geography from the foreclosure prevention programs. Refer to the 2009 interagency CRA questions and answers for information on activities that may revitalize and stabilize low- or moderate-income areas.

Investment Test Issues

Over the last few years, there has been considerable emphasis on providing investments that help to provide affordable housing (including rental housing) for low- or moderate-income individuals. The need for such housing still exists.⁵ However, with the current economic climate, the needs and opportunities for qualified investments in your assessment area may have changed.

In addition to the provision of affordable housing for low- or moderate-income individuals, community development⁶ includes

- community services targeted to low- or moderate-income individuals
- activities that promote economic development by financing businesses or farms that meet the size eligibility standards of the Small Business Administration's development company or small business investment company programs (13 CFR 121.301) or have gross annual revenue of \$1 million or less
- activities that revitalize or stabilize
 - low-or moderate-income geographies
 - designated disaster areas
 - distressed or underserved nonmetropolitan middle-income geographies designated by the board of governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and OCC

In general, banks need to continue to look at the needs and opportunities in their assessment areas and work with local groups and public entities to identify investment opportunities. When looking for investment opportunities, bankers should focus on the impact of

***Are you overpaying for compliance consulting services?
Did examiners uncover violations missed by your consultant?
Do you want to obtain quality services at a reasonable cost?***

IT'S TIME TO CALL ...



**Federal Regulatory Compliance Expertise Since 1978
Recipient of prestigious *FEDERAL RESERVE PRESIDENT'S AWARD*
Current client asset size: \$150MM - \$35B**

Call Toll-Free 877.658.7687

www.compliancebanksolutions.com

Reach this advertiser through <http://links.aba.com>



the investment as well as the dollar amount. Available investments may be smaller in dollar amount, but examiners consider more than just the dollar amounts. For all banks they must consider the responsiveness of investments to local community development needs and opportunities. For large banks they must also consider the innovativeness or complexity of the investments, along with the degree to which the qualified investments are not routinely provided by private investors.⁷

Don't forget to provide the examiners with information about investments that were made during the prior evaluation period that remain on the bank's books. Examiners consider and qualitatively weigh both current and prior-period investments. For example, a prior-period outstanding investment with a multi-year impact that addresses assessment area community development needs may receive more consideration than a current period investment of a comparable amount that is less responsive to area community development needs. And as always, investments must benefit the bank's assessment area or the broader statewide or regional area that includes the bank's assessment area.⁸

With the significant downturn in the national economy and the mortgage-backed securities market, banks are finding it difficult to find qualified investments. Some banks have also reduced their charitable donations. What kind of qualified investments are available now?

Opportunities to make qualified investments may have changed, but there are still needs; in fact, the need for investments related to providing community services for low- or moderate-income individuals in your assessment area may have increased. Qualified investments⁹ include but are not limited to the following:

- donations to local organizations that provide credit counseling to low- and moderate-income individuals
- financing community services to low- and moderate-income individuals, such as affordable day care for working parents, health care, and other services
- funding foreclosure-prevention programs that have the objective of providing affordable, sustainable, long-term loan restructurings or modifications to homeowners in low- and moderate-income geographies, consistent with safe and sound banking practices, that help to revitalize and stabilize those low- and moderate-income areas
- donating "other real estate owned" to CRA-qualified community development organizations as "in-kind" donations

CRA and "Other Real Estate Owned" (OREO)

One of the consequences of the current economic climate has been a sizeable increase in bank ownership of "other real estate owned" or OREO. Banks may employ a variety of strategies for removing these nonearning assets from their balance sheets. Two strategies in particular may result in positive CRA consideration as qualified investments.

Qualified investments include donations to CRA-qualified organizations, i.e., organizations whose primary purpose is consistent with the definition of community development in the CRA regulation.¹⁰ A bank may make a cash donation or an "in-kind donation" to a CRA-qualified organization. An "in-kind" donation could include things such as furniture, computers, or even real property, such as OREO.

Fair market value* of OREO	\$150,000
Sale price	50,000
Investment	\$100,000
* FMV is determined by a current, independent appraisal.	

In addition to an outright donation of OREO, a bank may sell OREO at a discount to a CRA-qualified organization. The difference between the fair market value and the selling price would be considered an in-kind donation.¹¹ See OREO accounting rules for more information about booking and selling OREO.¹²

The investment value of OREO sold at discount is calculated as follows:

Would donations of OREO to a government-owned land bank be considered qualified investments under the CRA?

Generally, no. A donation to a government-owned land bank is not typically a qualified investment because the primary purpose of government is not consistent with the definition of community development. However, if the land bank is a separate entity with a clear purpose that is consistent with the definition of community development, such activity could be considered a qualified investment. The bank would need to provide enough information to demonstrate that the primary purpose of the land bank is consistent with the definition of community development in the CRA regulation.

Investment test questions will continue to arise. As you encounter these situations, use the resources at

your disposal like the CRA regulation and interagency questions and answers.

Service Test Issues

Banks continue to receive positive CRA consideration for providing community development services targeted to low- or moderate-income individuals and for providing technical assistance to CRA-qualified organizations. Particularly in the current economic climate, individuals and businesses need access to financial services and community organizations still need access to technical assistance. In some areas, the need for these services has risen dramatically.

Banks may receive positive CRA consideration for community development services that are related to foreclosure prevention. Here are just three examples:

- providing credit counseling, homebuyer and home-maintenance counseling, financial planning, or other financial-services education to promote community development and affordable housing, including credit counseling to assist low- or moderate-income borrowers in avoiding foreclosure on their homes¹³
- providing technical assistance to organizations whose primary purpose is consistent with the definition of community development, such as lending bank employees to an eligible project or helping a nonprofit develop guidelines and standards for a foreclosed prop-

erty acquisition and rehabilitation program serving primarily low- or moderate-income housing or other CRA-qualified community development needs¹⁴

- providing foreclosure prevention programs to low- or moderate-income homeowners who are facing foreclosure on their primary residences with the objective of providing affordable, sustainable, long-term loan modifications and restructurings¹⁵

Many banks service portfolios of loans for other investors. May banks receive positive CRA consideration for activities they undertake to facilitate disposition of real estate obtained through foreclosure activities for loans that they service for other investors?

No. A bank would not receive community development services consideration for activities that it performs as a servicer on behalf of an investor. A bank receives positive CRA consideration for community development services that it provides directly or that are provided by an affiliate or third party on the bank's behalf. As servicer, the bank is not acting on its own behalf. When acting as servicer, the bank conducts foreclosure proceedings on those properties where the mortgagee has proved an inability to repay the obligation in accordance with the terms of the note. The pooling and servicing agreement governs the actions taken by the servicer on behalf of the investors, and as such, the servicer must maximize the value to the investor.¹⁶

Paying too much for CRA, HMDA or Fair Lending solutions?

We have delivered "Peace of Mind" for over 20 years.

Consulting - Let our experts provide you with guidance.

GenTrax Software - Easy, Complete, Affordable...really!

Services - We can do this work for you. You deserve it.

MARQUIS™

800.365.4274

GoMarquis.com

