

# **CRA - Community Reinvestment Act**

A beginner's view of what  
you need to know to comply



Are you new to the Community Reinvestment Act (CRA)? If so, you may have a few questions. Some have compared getting a role in Compliance to a nightmare that many have had. You know, the one where you walk into a classroom, back in school - only to find a major test is afoot, for which you have not studied. Can you say stress?! Yet, compliance shouldn't make anyone feel this way.

Questions like...What exactly is CRA? Why is it a regulation? Does every financial institution have to comply? What are the elements of effective compliance with CRA? Or, how is a bank rated? All of them may be swirling around your head. Answering these five questions is a great starting point, especially if you are new. It may even be great information for sharing in a training session for all employees and your Board of Directors.

## **What is CRA?**

Enacted in 1977, the Community Reinvestment Act (CRA) affirmed the obligation of federally insured depository institutions to help meet the credit needs of communities in which they are chartered (consistent with safe and sound operations). The Act also charged the federal regulatory agencies (the FDIC, the OCC, the Federal Reserve and the OTS) with implementing the CRA through regulations and by examining banks and thrifts to determine whether they meet their CRA obligations. As you may know, bank regulators take CRA ratings and exams into consideration when approving applications for new bank branches and/or for mergers or acquisitions.

CRA requirements and exams have evolved over the years. In fact, since CRA was enacted, the examiners have substantially amended this regulation. In each case, changes to the CRA reflected both experience gained in the implementation of the law as well as ongoing developments in financial markets and the economy.

OK, so what does this mean for you and for your bank? Your obligation is to "serve" the credit needs of your communities. If you serve Baltimore, MD, then you must serve all of this community and the individuals residing there without bias. Then, when the time comes for your next CRA exam, you must prove it. How do you do that? Well, we will discuss that soon enough, but first you must understand your institution's obligations toward the Community Reinvestment Act.

## **Why is CRA a regulation?**

Back in the late 1970s the public and the U.S. Congress were concerned with how financial institutions were serving high minority areas and the low & moderate income families in their publically stated "communities." Many were concerned that folks living on "the other side of the tracks" did not have equal access to credit and were summarily "redlined" and not marketed to or served by financial institutions.



Keep in mind that a variety of lending products operated substantially different 30+ years ago. As an example, much has changed in the way of mortgage lending specifically, as the secondary market for buying mortgage loans from financial institutions at that time was rudimentary at best.

The CRA was only one of a series of laws passed during the 1970s intended to reduce credit-related discrimination, expand access to credit and shed light on lending patterns. The CRA itself focused on the provision of credit to low-and moderate-income (LMI) communities rather than on discrimination by race, sex or other personal characteristics. Legislation that addressed discrimination in lending explicitly included the Equal Credit Opportunity Act and the Fair Housing Act. The Home Mortgage Disclosure Act was enacted to increase transparency in the mortgage lending market and to support public and private investment activity.

By the late 1980s, however, the issues surrounding access to credit were attracting renewed interest. In response to this interest, Congress included in the Financial Institution Reform and Recovery Act of 1989 (FIRREA) an amendment to the CRA statute to require public disclosure of institutions' ratings and performance evaluations. FIRREA also expanded data collection and made public certain data reported under the HMDA.

CRA was designed to check and see if banks and thrifts were lending fairly to their communities. Clearly, in the decades to follow, CRA exams progressed from "are you reaching out to your community and trying to make a difference" to "show me proof that you are "generating the loans, investment and services to meet the credit needs of these areas within your community." These changes are significant, but have happened slowly over time.

## **Does every financial institution have to comply?**

The federal CRA regulation requires that banks and thrifts of all sizes must comply with CRA. Credit Unions do not have any CRA requirement—although they do need to comply with the Home Mortgage Disclosure Act (HMDA), as do Mortgage Companies.

The actual CRA exams differ, however, based on the asset size of each institution or holding company. (NOTE: Three states also have CRA regulations; New York, Massachusetts, and Connecticut).

To keep it simple, we will discuss standalone financial institutions (and leave out the more complicated "Financial Holding Company" and "Limited Purpose or Wholesale Bank" conversation.) Banks that are smaller than roughly \$274 million (in assets) are considered Small Banks for CRA. Banks that are larger than \$274 million but smaller than about \$1.098 billion are considered Intermediate Small Banks, or ISB. Institutions greater than \$1.098



billion in assets (for the prior two calendar years as of December 31) are considered Large Banks. The spirit of each exam style for these three different groups is the same, but the exam process is different.

## What are the elements of effective CRA compliance?

In an effort to make this area of our CRA conversation relatively easy to convey, the content may be a little simplified. The nuances of preparing for a CRA exam and managing the exam itself are worthy of their own white papers. In this document, we will touch the highlights of CRA compliance, just to give you an overview of what the important elements are for meeting the needs of CRA at your institution.

Keep in mind, while the spirit of CRA exists in each type of CRA exam, the elements of compliance differ from Small, to Intermediate Small, to Large bank. To that end, this conversation must segment the key elements of CRA compliance into each of these three bank sizes.

First of all, unlike HMDA or Fair Lending reviews, from a loan perspective, CRA looks at a bank's originations and purchases exclusively.

### Small Bank – Less than \$274M in Assets (As of 12/31/2009)

- 1) Confirm that the bank's listed Assessment Area(s) (AA) is compliant and does not arbitrarily exclude low or moderate income geographies.
- 2) Does the bank have a reasonable loan/deposit ratio, based on the context of their market?
- 3) Is a substantial majority of lending within the bank's AA?
- 4) Is the distribution of loans by tract income level, etc., reasonable? Any gaps in lending? Do any of the low income tracts have zero loans?
- 5) Review lending by borrower income level, as available.
- 6) Review complaints.
- 7) Optionally, a Small Bank can opt to have their Community Development Loans, Investments and Services reviewed (consideration for an Outstanding CRA rating.)

### Intermediate/Small Bank (ISB) – Greater than \$274M in assets but less than \$1.098B (for the prior two calendar years as of December 31) As of 12/31/2009)



Items 1-6 in the Small Bank exam are also important elements in preparing for an ISB exam. But for an ISB Bank, there are actually two tests and the examiners expect more from you. Keep in mind, the more you know your CRA performance ahead of an exam and make adjustments based upon the context of your competition/ community story, the better off you will be. Waiting for the examiners to tell you what your CRA performance is during the exam is incredibly risky. Many ISBs have been misled into thinking that the regulators don't expect them to proactively manage their CRA activities.

What else must an Intermediate/Small Bank (ISB) prepare for?

- 8) Consider their lending performance in the context of economic conditions, bank capacity and condition and the specific needs of the assessment area under review
- 9) Assess the volume of lending inside the assessment area and the distribution of lending to HMDA, small business, small farm and optional consumer loan categories.
- 10) Review the extent to which lending activities are responsive to the particular needs in the assessment area, including the impact they have.
- 11) Consider community development activities that include lending, investments and services that support low- and moderate-income areas and people, as well as those activities that revitalize distressed areas or provide for job creation and/or retention and economic development efforts, including their responsiveness and impact .
- 12) Evaluate how these activities are undertaken within the framework of safe and sound practices.
- 13) Consider any illegal, abusive, and discriminatory practice that reduces the positive impact of CRA initiatives.
- 14) Review HMDA originations and purchased data to that of your peer group.
- 15) Optionally consider reporting annually the number and dollar of small business/ farm loans originated or purchased. This annual report is called the CRA Loan Register (LR). This will preserve the option for the bank to be eligible for review as a CRA Large Bank.
- 16) Evaluate small business/farm loans to those of your peers.
- 17) NOTE: While understanding the Community Development Lending, Services and Investments may be considered "optional" for a Small Bank Exam, it isn't an option for an ISB. In order for an Intermediate Small Bank to pass the ISB CRA examination, the bank must be rated as Satisfactory on both the Lending and Community Development tests.



Large Bank – An individual bank or bank holding company greater than \$1.098Billion (for the prior two calendar years as of December 31) As of 12/31/2009)

A large bank is evaluated under three tests. They include the Lending test, Investment test and Service tests. And, CRA Large banks must pass the Lending test with a Low Satisfactory rating, in order to potentially pass the overall CRA examination. Keep in mind, larger banks and thrifts typically have many more assessment areas on which to perform CRA analysis, and this work must be done for each one independently, and in unison for an overall bank CRA evaluation.

Data integrity is a huge watchword for examiners these days. This means that the examiners will want to confirm that the information about applicants and borrowers in loan files, matches the information reported for HMDA, the CRA LR, and for other loans being used to prove performance.

Managing an effective CRA program includes these items and a few others, some basic, some subtle, some sophisticated. Yet as we outlined early on, this conversation was intended to be a broad-brush look at what is required to manage CRA. Want to know more? The regulators make everything you need to know available at their respective web sites. It isn't hard to find; simply go to your regulator's site, and enter "CRA" in the search function.

## **How is a bank rated?**

As mentioned earlier, a bank's CRA rating will be taken into consideration by the regulators when approving applications for new bank branches and/or for mergers or acquisitions. Failure to comply with CRA effectively may present even more serious consequences.

So, how is each bank examined or rated by the regulators? Again, the spirit of the exams are the same, but the ratings are generally more complex the larger your financial organization. In the basic sense, overall, there are only four ratings; Outstanding, Satisfactory, Needs to Improve and Substantial Non-Compliance. Within the CRA Large Bank designation, each individual test has potential ratings of Outstanding, High Satisfactory, Low Satisfactory, Needs to Improve and Substantial Non- Compliance.

A Large Bank must achieve a Low Satisfactory rating on its Lending Test in order to be eligible to pass the overall CRA examination. An ISB bank must obtain a Satisfactory on both the Lending and Community Development test in order to pass the CRA Examination.



How do the examiners decide which of these four categories your bank's CRA performance fits into? This again depends on how the bank is classified; Small, Intermediate or Large. Generally, each bank's CRA performance will be measured in how well they met the needs of their community. A passing grade means you will at least have a satisfactory overall rating. In addition, how you fare in your fair lending exam will impact your CRA rating.

However, as indicated in the regulation, a bank's performance need not fit each aspect of a particular rating profile in order to receive that rating. From a Large Bank perspective, exceptionally strong performance with respect to some aspects (Lending for example) may compensate for weak performances in others (let's say Service.) The bank's overall performance, however, should generally be consistent with the appropriate profile stated in the formal exam procedures.

## **Making sense of what you need to know to comply with CRA**

While CRA is ever-changing, the regulators generally make it clear what they are looking for from your bank. The key to delivering a positive result for you and your bank is in evaluating your CRA performance before the examiners arrive. Only then can you be assured that the CRA rating result is one you can expect or accept.

You must manage the process. This means that you need to know what your distribution of lending is in your assessment area. You must identify if you have gaps in lending to LMI tracts. You should examine your CRA LR and HMDA LAR lending patterns and see if they are the equal of your peers, if not better. As it relates to community development lending and investments, are you tracking these activities? You need to. How are you serving your assessment area(s)? Are you extremely accessible to all areas in your market?

In the end, if you have managed your CRA process and information continuously throughout the year(s), then you should know your performance in advance, and be able to raise any concerns early. If you have done so, your CRA rating is something manageable. You should be able to give the examiners proof enough of your CRA performance, given the context of your market(s), to get at least a "Satisfactory" rating. Can you get an "Outstanding" rating? It is possible, but likely only with outstanding Lending, Service and Investment performance.

Given a little time (and maybe more management support), every CRA officer should be able to manage to at least a "Satisfactory" CRA rating. Want to learn more about CRA? Conferences that speak to CRA requirements are held throughout the country on a regular basis. In addition, everything you need to learn is available from your regulator. Don't bury your head in the sand and think CRA is too much for you. The requirements of CRA may be new to you, but they are not hard to understand or accomplish. You can do it!

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