FEDERAL RESERVE BANK OF SAN FRANCISCO

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CRA Data Collection - Answers to Perplexing Questions

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1997 was the first year that both large and small institutions were examined under the new CRA. In March of this year, large institutions finished their second reporting cycle of CRA data, a process that underscored the need for additional information related to CRA data collection. Beyond data collection, however, there continue to be a number of questions related to the examination process under the new CRA. To address some of these perplexing issues, Community Investments teamed up with Bankers' Compliance Group, Inc. (BCGI). Together, we developed a Q & A format which we hope will address a variety of issues in an efficient and effective manner. Our thanks to Carol Cordova at BCGI for volunteering her time and expertise to provide the following information.

Data Integrity

Q: Can a loan renewal be counted as a loan origination?

A: Under the new data collection rules, unfortunately no. This position is different from the regulatory agencies' original interpretation that a loan renewal could be counted as a loan origination if a new credit decision was made (substance over form). According to the newly revised Federal Financial Institutions Examination Council's (FFIEC) Interagency Questions and Answers (issued October 6, 1997), a loan *refinancing* typically involves

the satisfaction of an existing obligation that is replaced by a new obligation undertaken by the same borrower (i.e., taking a new note). For example, suppose a one-year business line of credit is maturing and the borrower wishes to renew the line of credit. After considering whatever information it deems necessary, the bank agrees to renew the loan for an additional one-year period, and has the borrower sign a new note. In this instance, the loan refinancing is considered a new obligation and would be counted as a loan origination.

On the other hand, when a change-in-terms agreement or other modification agreement is used to extend the maturity date or make other material changes, the loan is considered renewed (extended) or modified. A loan renewal or modification of this nature would not be counted as a loan origination for CRA data collection and reporting purposes. In short, whether a loan renewal can be counted as a loan origination is now based on form rather than substance. Additionally, this was dealt with by the Federal Reserve Bank of San Francisco in a letter to all state member banks dated March 16, 1998, in which the Reserve Bank emphasized the distinction between refinancings and renewals.

Keep in mind that information collected and reported from the CRA data collection software is just a starting point for an institution's CRA exam. It is not the be-all or end-all of an institution's CRA exam. At the time of examination, an institution is permitted (and even encouraged) to provide additional information (i.e., information on its loan renewals) on its lending performance, especially if the institution believes that its lending performance cannot be meaningfully measured without this additional data. Moreover, the federal banking agencies and bankers alike agree that the current CRA data collection process is not a perfect system. In fact, earlier this year the FDIC requested comments on how to improve the data collection process and make it less burdensome on financial institutions (*Federal Register* January 22, 1998).

Q: If a loan meets the definition of a home mortgage, small business or small farm loan and qualifies as a community development loan, how should it be reported?

A: Unfortunately, except for multifamily affordable housing loans, which may be reported by retail institutions under HMDA as home mortgage loans and under CRA as community development loans, retail institutions must report loans that meet the definition of a home mortgage, small business or small farm loan as such - even if they also meet the definition of community development loans. For example, suppose a bank makes a loan to revitalize a low-income area located within an enterprise zone. Coincidentally, this loan also meets the definition of a small business loan. The institution would be required to report the loan as a small business loan.

Again, information collected and reported from the CRA data-collection software is just the starting point of an institution's CRA exam. At the time of examination, institutions should seriously consider supplementing their reportable loan information regarding the dual-purpose nature of the institutions' lending. This is especially important if a portion of an institution's home mortgage, small business or small farm lending was through a third-party or consortium lender (i.e., loan pool commitments).

Q: What street address should be used for evaluating an institution's loans under the CRA performance standards?

A: The answer depends upon the type of loan: for consumer loans, an institution should look to the address where the borrower resides; for small business or farm loans, use the address where the main business facility or farm is located; and for home mortgage loans, where the property is located. For small business loans, the institution can also use the location where a majority of the proceeds will be used (this is helpful, for instance, in

connection with construction loans). Remember: when downloading the data from the mainframe for purposes of analysis, be sure to retrieve the correct address - that is, the facility or proceeds address - not necessarily the billing address. Furthermore, if downloading or inputting information into the data collection software at a later date, remember to keep the integrity of the original address intact. If the borrower moves or changes its address after the loan is originated, the address at the time the loan was originated must be maintained.

It is extremely important that the data be accurate. In the area of HMDA reporting, the regulatory agencies are assessing civil money penalties, as a routine matter, for late HMDA LARs and inaccurate data. It shouldn't surprise anyone if the regulatory agencies start imposing the same penalties for late or faulty CRA-record submissions in the not-too-distant future.

Q: Should an institution analyze ***all*** *loan originations or just its reportable loans: specifically, mortgage loans, small business loans and small farm loans?*

A: A large retail institution (greater than $250 million in assets) is required to collect and report to their regulatory agency each calendar year-end (beginning with December 31, 1996), information on small business, small farm and home mortgage loan originations and purchases. The starting point for the examiners is a review of the institution's loan originations and purchases of reportable loans since the institution's last exam. If the institution can furnish its own analysis of reportable loan originations and purchases, then it has the necessary information to respond to any questions from or conclusions drawn by the examiners, should they decide to review only a sampling of the institution's reportable loan originations and purchases.

The institution also has the option to provide additional data concerning its lending activity, such as information on its entire loan portfolio, and should do so to the extent that the information would enhance the institution's performance. However, the institution must assemble and present such additional information to examiners.

The purpose of analyzing loan data prior to a CRA exam is to prepare in a proactive manner for the exam. By analyzing the data ahead of time, the institution can: 1) gauge its performance, 2) review and correct any potential deficiencies that could produce a less-than-satisfactory rating, and 3) educate the board of directors and management about its current efforts and results in meeting the credit needs of its communities. Because the examiners are required to evaluate the institution's reportable loan originations and purchases, we recommend that the institution analyze at least this same information. If the institution has the resources to analyze its entire loan origination portfolio or loans outstanding, we recommend that the institution conduct such an analysis as a secondary measure.

Conversely, examiners will evaluate a small institution's performance based on all of its loan originations and purchases. Like large institutions, however, a small institution has the option of assembling and presenting additional loan information, such as information on loans outstanding, if it will enhance the institution's performance.

Q: How must an institution evaluate its small business and small farm activity?

A: There are actually two steps in evaluating a retail institution's small business and small farm loan activity. The first step is to determine whether the financial institution is making small business and farm loans (as defined in the Call Report instructions). For small business loans, an institution must report the number and dollar volume of all small business loans $100,000 or

1 less, more than $100,000 but less than or equal to $250,000, and more than $250,000 but not more than $1 million. For small farm loans, an institution must report the number and dollar volume of all business and farm loans of $100,000 or less, more than $100,000 but less than or equal to $250,000, and more than $250,000 but not more than $500,000.

In the second step, the institution must determine out of all of its defined small business and farm loans, how many are to businesses or farms with gross annual revenues of $1 million or less, using the gross annual revenues the institution considered in making its credit decision. It is the amount of the loan that first gets reported and then a determination is made as to the revenue size of the business or farm; not the reverse.

Q: If it is determined that consumer loans are a "substantial majority" of a retail institution's business, can the institution pick and choose which categories it wants to have evaluated?

No. The institution is, of course, free to collect data on one or more categories of consumer lending and provide it to the examiners as supplemental information. If the institution chooses not to collect such information, though, examiners will still evaluate one or more of the appropriate categories if the institution's consumer loans constitute a "substantial majority" of its loan portfolio by number or dollar volume. These categories are:

- Motor vehicle loans;
- Credit cards;
- Home equity loans;
- Other secured consumer loans; and,
- Other unsecured consumer loans.

If consumer loan data is not provided by the institution, examiners will analyze a meaningful sample of the appropriate categories of an institution's consumer loan portfolio. This may be to an institution's benefit or detriment, depending on its performance and whether the sample accurately reflects the institution's overall consumer loan portfolio.

Q: For consumer loans, what constitutes a "substantial majority " of an institution's business?

A: Unfortunately, there is no magical number or percentage (i.e., greater than 50%) that defines a "substantial majority." The agencies interpret "substantial majority" to the extent that the Lending Test evaluation would not meaningfully reflect the institution's lending performance if consumer loans were excluded.

Q: If an institution decides to collect data on its consumer loans, how should the institution +ort consumer construction loans, and wI3icb location should be used for the loan: the borrower's address or the construction property `s address?

According to an informal discussion with staff of the Federal Reserve Board, a financial institution's portfolio of consumer construction loans would be categorized under "other secured consumer loans." (This assumes that the loans are not reportable under HMDA because they are temporary financing with no commitment for permanent financing from the financial institution.) With regard to loan location, staff believes that since the regulation is unclear as to which address to use, the institution could use either the borrower's address at the time of loan origination or the construction property's address, as long as the financial institution is consistent in its approach. However, staff recommended using the construction property's address, which seems to make the most sense.

Assessment Area

Q: Since the assessment area is not one of the performance criteria of the CRA exam, and an institution cannot be criticized for its delineation, how could the assessment area delineation impact an institution's performance?

A: Don't be lulled into a false sense of security here. While an institution's assessment area delineation is not a separate performance standard, if, during an examination, it appears that an institution has not complied with the four requirements for delineating its assessment area, an examiner could recommend the institution redraw its area. Consequently, the institution's CRA evaluation would be based on an entirely different assessment area - not the one it originally delineated and upon which it reported its loans and based its impact on the institution's CRA performance rating. It is important that an institution review its assessment area carefully and document its rationale for the delineation (i.e., objective business reasons) prior to the exam.

Q: How often should a financial institution review its assessment area(s)?

A: It is recommended that both large and small financial institutions review their assessment area(s) at least annually. This analysis should include a review of: 1) the geographic distribution of lending activity to help determine if the borrowing base has expanded beyond the current delineation to the point where the majority of the institution's loans (in both number and dollar volume) is not confined to the current boundaries; 2) the institution's current capacity and constraints; and 3) the institution's marketing strategy and business plan for the upcoming year.

Investments

Q: How much is enough?

A: This seems to be the most perplexing question under the new CRA regulation. Bankers and examiners alike are still in a quandary as to how much an institution should maintain each year in community development investments. The regulation itself does not provide guidance on how much a financial institution should have in qualified investments to obtain a "satisfactory" rating.

So, how much is enough? While the regulation itself provides little guidance, there have been numerous strategic plans approved by the regulatory agencies. These strategic plans include measurable goals for, among other things, community development investments that the institution has committed to obtain to achieve a satisfactory or outstanding rating. Also, the strategic plans describe the types of investments in which each institution has committed to invest.

It would be beneficial to review these approved plans to see how other institutions approach the issue, and what the regulatory agencies view as "enough" at least with respect to that particular institution. One might review the ratio of total qualified investments to the institution's net income or total assets.

A list of the approved strategic plans can be obtained through each regulatory agency's website. Hard copies of the plans can be requested from the specific regulatory agency or financial institution.

Services

Q: How should a financial institution document its record of community development services?

A: It is important to document the *types* of community development services in which an institution is involved. And it is equally important to document the *number of hours* that the institution's employees devote to those

activities. In order to get credit as a community development service, the service must be performed by the employee in his or her official capacity.

Performance Context

Q: Will examiners consider a performance context provided by an institution?

A: Yes! An institution may provide examiners with any information it deems relevant, including information on the lending, investment and service opportunities in its assessment area(s). Although the regulation does not specifically require an institution to prepare its own performance context, it is often helpful to do so. In order to explain properly its performance under the new CRA regulations, the institution must have a thorough understanding of its assessment area prior to the examination. Note, however, that the agencies will not evaluate an institution's efforts to ascertain community credit needs or rate an institution on the quality of any information it provides.

Q: Where can peer group information be found?

A: For home mortgage data, the HMDA disclosure statements can be obtained from the peer institution or from the FFIEC through its HMDA assistance line at (202) 452-2016. For small business and small farm data, the CRA Disclosure Statements can be obtained from the CRA assistance line at (202) 872-7584. Also, the CD-ROM program entitled "1996 CRA Aggregate and Disclosure Software" (version 1.0a) can be obtained from the FFIEC's website. For other types of loan data (consumer loan or business loan data for loans over $1 million), this information can be obtained from the peer institution's public section of its CRA Performance Evaluation. These can be requested from the peer institution or its regulatory agency. In fact, the OCC has started to post its public evaluations, for both large and small

institutions, in a down-loadable format on its website (http://www.occ.treas.gov/cra/electric.htm).

Public File

Q: What information must be maintained in the CRA public file if an institution elects to have one or more categories of its consumer loans considered under the Lending Test?

A. When a financial institution opts to have one or more of its consumer loan categories (i.e., motor vehicle, credit card, home equity loan, other secured or other unsecured loans) considered under the Lending Test evaluation, the following data for that category of consumer loans must be included in the public file:
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- The number and amount of loans to low-, moderate-, middle- and upper-income individuals;
- The number and amount of loans located in low-, moderate-, middle, and upper-income census tracts; and,
- The number and amount of loans located inside the institution's assessment area and outside the assessment area.

Many of the issues addressed in this article will be covered in detail at a special CRA Training Seminar that will be held in five California locutions in June 1998. For more information, contact: Carol A. Cordova, Bankers' Compliance Group, Inc., 18200 Von Karman Avenue, Suite 730, Irvine, California 926l2, (714) 553-0909 or, (888) 599-1193.

What is Bankers' Compliance Group, Inc.?

Bankers' Compliance Group, Inc. (BCGI) is a subsidiary of law firm of Aldrich & Bonnefin, P.L.C. It provides banking-related consulting services in the areas of: CRA compliance (including year-end reporting), auditing, public file review, drafting and reviewing internal CRA programs and procedures, and

training on CRA software. BCGI also provides unique analytical products including maps, reports and geocoding of lending and deposit activity in the areas of CRA, HMDA, fair lending and risk assessment. BCGI also offers compliance consulting in establishing compliance management programs and loan documentation system-setup and training. For more information about the company's services, please call (888) 599-1193.

About the Author

Carol A. Cordova specializes in establishing training and auditing programs, maintaining current and active compliance programs and creating various reporting tools to manage compliance with the ever-changing regulatory landscape. Ms. Cordova has over 15 years of compliance experience, especially in CRA. She is Vice President and Compliance Manager of Bankers' Compliance Group, Inc.