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# EXAMINATION PREPARATION:

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HOW TO ENSURE  
YOUR INSTITUTION  
IS READY FOR A  
**COMMUNITY**  
REINVESTMENT ACT  
**EXAMINATION**

The Community Reinvestment Act was enacted in 1977 in order to ensure financial institutions were meeting the needs of all areas of its community in which it operates. The CRA's intent is not to encourage unsafe or unsound lending practices, but rather to ensure banks are not ignoring certain areas, businesses, and individuals that live in its community, especially those that are low and moderate income and considered small businesses and small farms. The CRA does not apply to credit unions.

The results of CRA examinations are important for a number of reasons. First, the results can grossly affect the bank's strategic growth plan. The CRA rating is taken into account when regulators are reviewing branch applications, mergers and acquisitions. A less than satisfactory rating can affect the bank's ability to grow.

In addition, CRA exams and ratings are public information that anyone can review. Therefore, there is a great deal of reputation risk, which makes it essential to be prepared for your examination. From community groups to potential customers, anyone can see your record of serving its community. A negative record can affect your public image, brand, and employee satisfaction and retention. It is not something you want to be known for throughout the community.

As with all compliance exams, preparation should be ongoing. The following outlines some helpful tips and areas to focus to ensure a successful examination.

## Background Information

There are five different types of examination based on the size and type of the institution, small institutions; intermediate small institutions; large institutions; wholesale/limited purpose institutions; and institutions with strategic plans.

**All assets listed below are effective as of January 1, 2014 and are updated annually.**

# Small Institutions

A small institution is one that has less than \$300 million in assets as of December 31 in either of the two prior calendar years. The exam is a streamlined version with five performance criteria reviewed:

1. Loan-to-Deposit Ratio;
2. Lending activity in the assessment area;
3. Distribution of lending based on borrower income levels;
4. Distribution of lending based on geographic income levels; and
5. Institutions action in response to any written CRA complaints.

# Intermediate Small Institutions

Intermediate small banks are defined as banks that have at least \$300 million as of December 31 in both of the prior two calendar years, and less than \$1.202 billion as of December 31 in either of the prior two calendar years. There are two tests the small bank lending test listed above and a community development test.

For the community development test, examiners will look at the total number and dollar amount of community development loans, qualified investments, and community development services. It will also look at the needs of the community and opportunities for community development activities. The analysis will examine the bank's ability to meet those needs of the assessment area.

Intermediate small banks are not required to report CRA loan data for small businesses and small farms, but may opt for evaluation under the large bank test.

# Large Institutions

A large bank is a bank with assets greater than \$1.202 billion as of December 31 in both of the prior two years. The large bank exam looks at lending, investments, and service tests.

The lending test is weighted the heaviest, and looks at your HMDA, Small Business, and community development lending.

# Wholesale/Limited Purpose Institutions

A wholesale/limited purpose institution is a bank that does not extend home mortgage, small business, small farm, or consumer loans in the normal course of business. Wholesale/limited purpose exams evaluate community development including lending, investments and services.

## Strategic Plan

Any institution may submit for approval a strategic plan for how it will comply with its CRA requirements. The plan must contain measurable annual goals and must be created with input from members of the public. A strategic plan must be published for public comment prior to approval by its primary supervisory agency. The exams are very straightforward. Examiners will first look at whether the goals were met. Since the goals were already approved, if they are met the appropriate agreed upon rating will be assigned. If some or all of the goals are not met, examiners will have to exercise judgment to determine the rating.

Examination procedures for each exam type are posted on each of the regulators websites, as well as interagency exam procedures on the FFIEC's website. They are a great place to start to see exactly what examiners will be reviewing and how they will consider each criterion come exam time. There is some subjectivity when it comes to CRA examinations so reviewing performance evaluations is helpful to see how examiners are determining ratings.

## Proactive Compliance Program

Although the examination types have slightly different focuses, there are underlying themes and ways to prepare that apply to all CRA examinations. Every bank should have a CRA strategy set by the Board and communicated throughout the institution. The strategy should first assess the needs of the community and determine if the products and services offers meet those needs.

Examination preparation should be ongoing and start as soon as the previous examination ends. As with all exam preparation, the best way to be prepared is to have a proactive CRA program. You do not want to wait until the last minute as it will not allow enough time to correct any issues. You want to know where your strengths and weaknesses are and what you are doing to correct those weaknesses if those weaknesses can be corrected.

Examinations are documented on a Performance Evaluation (PE). Templates for each exam type are available on all the regulators websites. It is a good idea to take the performance evaluation and continuously update it based on current information at some regular interval such as quarterly. This way you will always know where you stand from a CRA perspective.

It is important to keep the Board informed of your CRA standing. They should receive regular updates on your performance such as submitting the bank created updated PE to the Board.

## Performance Context

Your performance context outlines the CRA environment in which you are operating. You need to know this like the back of your hand. You need to be able to tell your story. You want to be able to describe your institution, your assessment area, and any other important factors that might affect your CRA performance. Keep a written, updated document that contains the following information.

### **Know your Background and Strategy**

You will want to provide examiners with your institution's background and strategy. Include how many branches and offices, where they are located and the income levels of the census tracts where they reside. Also include any loan production offices and ATMs. You will want to note whether there are any differences in the services offered between the branches and the reason for those differences.

### **Know your Financial Condition**

You will want to know your financial condition and data. Know your liquidity and capital positions and whether there is anything that might impede your ability to lend.

### **Know Your Products**

Be able to outline what your main product lines are and your focus. Know your portfolio mix and what constitutes the majority of your loans.

### **Know your Assessment Area**

Know the specifics, the people that live there and the businesses that reside there. Know the income levels of the census tracts and whether the specifics of certain areas such as where single family houses, apartments, industry, etc. are located. Know the economic conditions including employment data and major employers of the area. If no lending is occurring in certain areas, be able to explain why.

## Know the Community Groups

Know the community groups in your area. Examiners will conduct community contacts. During the community contact, examiners will call community groups to see what they feel the needs of the area are and whether they feel financial institutions, in particular yours, are meeting those needs. You should do the same. Talk to people in local organizations to find out what the needs of the area is and how you can meet them.

## Know Your Complaints

Review any comments that are in the public file relating to your CRA performance to make sure they were resolved in a timely and satisfactory manner. Also review any fair lending, Regulation B or FHA violations as these can affect your overall CRA rating.

## Know your Peers

CRA is the one regulation where you will be directly compared to your peers. It is important to know who your peers are and what their CRA performance looks like. Since performance evaluations are public, you can review each of their previous performance evaluations to see how they were rated and how your institution compares. Look for institutions of similar size, strategic plans and the same regulators.

All of these items should be communicated to your regulators during the exam. It should set the tone for who the bank is, what it does, and any impediments to serving its community.

# Community Development

It is very important to understand the definition of community development to ensure what you are reporting meets the definition of a community development loan, service or investment. Community development is:

- Affordable housing for LMI Individuals;
- Community services targeted at LMI individuals;
- Activities that promote economic development;
- Activities that revitalize or stabilize

- LMI census tracts,
- Designated disaster areas,
- Distressed or Underserved Non-Metropolitan Middle income census tracts; or
- Abandoned or foreclosed homes

For large banks, a community development loan cannot be double counted with the exception of multifamily HMDA loans that qualify. If a loan is already reported as a small business or HMDA loan, it cannot be counted towards your community development loans. You may want to keep track of these loans separately for your performance context.

Community development investments are investments made with the purpose of community development. Examiners will look at the dollar amount of the qualified investment, the innovativeness or complexity of the investments, the responsiveness of the investment to meet credit and community development needs, and the degree to which the investment is not routinely provided by private investors.

Community development services are those that meet the definition of community development and provide a financial service. For example, volunteering to serve food at a food pantry would not qualify, however, providing credit counseling at a food pantry would likely qualify. Do not wait until the last minute to start collecting information on all employee's service activities. This should be an ongoing process. Train your employees on what constitutes a CRA activity. Have them report dates, times, and hours regularly.

For all your loans, investments, and services, ensure you are collecting data on the organization and activity. Documentation is key. You need to be able to show how the organization meets the definition of community development. Collect their mission statement and as much details as possible.

## Assessment Area

Although not a separate exam criterion, the assessment area will be reviewed to ensure it is in compliance with regulatory requirements. It will also be used as the basis for the lending tests as you need to ensure you are serving the entire assessment area. It is up to the financial institution how it draws its assessment, but it must meet some basic minimum requirements.

### **For Wholesale or Limited Purpose Banks:**

- Must consist of one or more Metropolitan Statistical Areas (MSA) or Metropolitan Divisions (MD) or one or more contiguous political subdivisions such as counties, cities or towns in which the bank has its main office, branches, and deposit taking ATMs

### **For Other Banks:**

- Must consist of one or more MSAs or MDs or one or more contiguous political subdivisions, such as counties, cities, or towns; and
- Include the geographies in which the bank has its main office, its branches, and its deposit-taking ATMs, as well as the surrounding geographies in which the bank has originated or purchased a substantial portion of its loans (including home mortgage loans, small business and small farm loans, and any other loans the bank chooses, such as those consumer loans on which the bank elects to have its performance assessed).

It is important to at least annually review your assessment area to ensure compliance. An assessment area must consist of whole geographies. It should not arbitrarily exclude high minority areas or low or moderate income census tracts. An assessment area may not extend substantially beyond an MSA or state boundary unless the assessment area is located in a multistate MSA. If a bank serves a geographic area that does extend substantially beyond a state boundary, there needs to be separate assessment areas for the areas in each state. If a bank serves a geographic area that extends substantially beyond an MSA boundary, there should be a separate assessment area for the areas inside and outside the MSA.

A good idea is to look at the assessment area on a map to see the breakdown of the assessment area. Ensure you include the census tracts just outside the assessment area in your analysis to determine if any low or moderate income tracts are randomly excluded. In addition, look at the assessment area from a fair lending perspective. You also want to ensure that no high minority census tracts are not haphazardly excluded. You do not want to be accused of redlining.

Review your lending data to make sure the majority of your loans are made in the assessment area. If not, determine why and if there are any necessary changes that should be made as a result. Also conduct a gap analysis. Analyze why there are any areas in the assessment area where the bank is not lending. Be able to explain any anomalies in your performance context.



# Public File

Prior to the exam, double check your public file to make sure that all necessary items are included. A simple checklist documenting this review is helpful. The review should be conducted annually keeping in mind the required timelines for updating the file. The public file must be accurate as of April 1.

Ensure to review of each of your branch's abbreviated public files as well. Make sure all the public files are complete, up to date and contain all necessary information.

# CRA Notice

CRA requires a notice to be placed in the public lobby of its main office and each of its branches. Double check that the correct and updated notices are hanging in the lobby. The notice can be found in Appendix B. You would be surprised how frequently these signs are out of compliance. It is a quick review and worth the double check.

# Lending Test

On a regular basis, analyze your lending data. Look at your loan to deposit ratios for each quarter since the previous exam. Also compare your loan to deposit ratio to your peers.

The exam will look at the following areas:

- The amount of HMDA, Small Business, Small Farm and consumer loans (optional reporting) if the assessment area.
- The geographic distribution of loans in the assessment area.
- The borrower distribution based on income levels for HMDA and consumer loans, or gross annual revenues for Small Business and Small Farm loans.
- Community Development Lending

The exam will also look at innovative and flexible lending practices.

# Additional Efforts to Help You Prepare

It is extremely important to have comprehensive documentation of your CRA efforts. Documentation must be clear and understandable. Be prepared with all back-up documentation that may be requested at a later date. If you are stating an organization caters to low and moderate income individuals, you need to show what the organization considers low and moderate and whether it meets the same criteria as the regulation. Collect all the organizations mission statements and any information that will help show why it qualifies as CRA. Do not give examiners the opportunity to question an organization's qualifications. Provide them thorough documentation.

## Conclusion

Once you receive the request letter, you will have a better idea of what the examiners will focus on at the upcoming exam. However, it is too late to do anything at that point. You do not want to make a quick investment or loan that may be unsafe and unsound just to help your CRA numbers. This will backfire. You must be prepared. The time after you receive the request letter should be about organizing information, not creating it. It is a time to give everything a once over so there are no surprises come exam time.

As with any compliance exam, a proactive CRA program is the best way to prepare for an examination. Use the resources available to you from your specific regulatory agencies and the FFIEC. A thorough read of your previous performance evaluation, your peers' performance evaluation, and exam procedures will provide great insight to the exam process and allow you to know what to expect when examiners are onsite. Know your data and the needs of your community thoroughly. Know your performance context. You do not want examiners to tell you about the individuals and businesses you are supposed to be serving. You should be telling them.