

ABA **Bank** Compliance

MAY | JUNE 2022

SANCTIONS AGAINST RUSSIA

Understanding the
Evolving Picture and
How to Respond

Conduct an Internal
Compliance Investigation

Reassess Overdraft Programs

Evaluate Fair Lending
and Discrimination Risk



Sharing Your CRA Story

Why Performance Context is Important for your Examination

WE HAVE ALL HEARD ABOUT IT and seen it included in Community Reinvestment Act (CRA) examination reports, but many banks have yet to tackle creating their own Performance Context. Since there is no regulatory requirement for banks to complete their own Performance Context narrative, many banks have yet to embrace investing in the research needed to prepare it. However, by not doing so, you are likely missing out on the opportunity to share important details about your bank's CRA activities and assessment areas that could have a material impact on your CRA rating.

The Basics

Performance Context is a key consideration during any CRA examination, whether it is prepared by the bank or the bank's examiner. In the simplest terms, Performance Context is data and information that provides clarity and insight into why a bank's performance during a CRA examination may be above or below expectations. It provides a deeper look at variety of factors that could be affecting the bank's ability to meet lending or other community development needs.

Within the CRA regulation, the agencies have provided a formal definition of "performance context" as it relates to the assessment of bank activities during examinations. Performance context applies to every institution, regardless of whether it is examined through traditional asset-size tests, as a wholesale/limited purpose bank, or under a strategic plan.

Performance Context can include a variety of factors that may influence a bank's CRA activities. The regulators have shared that they will consider:

- Demographic data such as median income levels;
- Distribution of household income;
- Nature of housing stock;
- Housing costs; and

- Other relevant data pertaining to a bank's assessment area.

They will also consider:

- The overall economic climate at the national level as well as locally and regionally;
- The bank's past performance compared to similarly situated lenders in the bank's assessment areas;
- The bank's size and financial condition, safety and soundness limitations, and any other factors affecting its ability to provide lending, investments, and services;
- The bank's record of complaints or compliments received from the community, as included in its CRA public file; and
- Information about the opportunities to lend, invest, or serve the bank's assessment areas, including competition from other banks and non-banks in the same area and data from community organizations or state, local, or tribal governments.

Should I Prepare Performance Context?

Any banker that has read a CRA examination report knows that it includes lengthy discussions of Performance

Context prepared by the bank's examiner. This Performance Context includes many of the basics including an assessment of the bank's financial capacity, economic and demographic factors, and bank competition analysis. You may be wondering why you should prepare Performance Context if the examiners have it covered. With so many other things that have to be done, why not let the examiners handle this one?

The answer is simple. No one knows your bank and the markets it serves better than you. Every day, you are evaluating CRA performance as part of your risk management activities. You are thinking about the level of lending in your assessment areas and seeking out opportunities for investment and community service. You are being brought into discussions on new products and marketing initiatives to ensure your CRA expertise is included in reaching the right homeowners, borrowers, and businesses in your communities. You work to build relationships with key community partners who understand and strive to address critical needs in communities. You also live and work in the community your bank serves. This local knowledge adds a layer to Performance Context that data analysis can never replicate.

Where to Begin

While the regulators have laid out the general categories of data that a bank can consider for Performance Context, the search for data will be overwhelming. If you conduct an online search for economic data or community needs, you can easily head down a dozen rabbit trails. The first step is to start with what you know—your bank.

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lending performance as well as investment and service levels to ensure that the bank is meeting community needs. Most banks utilize software to compare their lending activity to aggregate data from other lenders in their assessment area and demographic data from public data sources, like the Census Bureau.

As you analyze that data, think about external factors that could be influencing the bank's performance. If lending to small businesses is below aggregate or demographic data, is it because your bank is a small institution in a crowded market or maybe there are national lenders consuming all of the loan opportunities? If your bank is having difficulty lending to low-income homeowners, is it possible that there are a high number of low-income individuals who rent instead of buy homes or a general lack of affordable

homes to buy in your market? Has the bank tried to work with community partners to raise awareness about homeownership in low-income neighborhoods?

Answering all of these questions provides Performance Context beyond simple data analysis that you can share to explain why the bank's lending activity is above or below expectations.

Take a close look at where your bank stacks up to competition in your assessment areas. Each year, the Federal Deposit Insurance Corporation (FDIC) publishes a Summary of Deposits Survey which evaluates banks based on deposit market share. Data from this Survey can be searched on the FDIC's website. Similarly, each year public data is released from annual HMDA and CRA filings that aggregates lenders based on performance by market. Utilizing this data,

banks can evaluate their overall presence in a market and the level of competition from other banks, which could have a significant impact on opportunities for lending, investment, and services.

Look to the past to prepare for the future. How did your bank perform at its last CRA examination and where are the areas for improvement? Did you excel in one CRA factor or assessment area and how do you sustain or replicate that performance in the current examination cycle? Has the bank received compliments or complaints from customers or community stakeholders that speak to how it is meeting community needs or ways to improve?

Economic data also adds important aspects to Performance Context and there is no lack of resources for accumulating such data. Each year, the U.S. Cen-

sus Bureau publishes a series of updates through the American Community Survey and other research that outlines demographic, economic and housing data throughout the country. The Bureau of Labor Statistics also provides great insights into overall economic and employment data. Other federal agencies provide data on housing, such as the U.S. Department of Housing and Urban Development and the Federal Reserve Banks. A general search can also supply basics such as the region's cost of living (general and for housing, poverty rates and average credit scores).

Gleaning information from Federal data sources is important, to the extent that it is relevant to how the bank is performing under CRA. Once you have identified and accumulated the key data points from Federal data sources, you will need to interpret that data and provide details as to how it impacts bank performance. For example, how is income and unemployment trending in your assessment areas and how does that compare to your underwriting standards? Are rents becoming more or less affordable and what does that do to overall homeownership? Are there national economic factors, such as the pandemic, that have had a significant impact on households and businesses and how has that changed the availability of CRA opportunities and ability to conduct outreach in your community?

Don't forget about local partners. Just like you know your bank's markets, local or state governments or economic development agencies are often conducting their own research and studies that can be a wealth of information. Does your local chamber of commerce have research that discusses overall business and employment trends, major employers, or other important economic data? Has the local government created a master redevelopment plan or targeted certain areas for revitalization or stabilization? Is there a tribal government in your assessment area and what unique needs has it identified in the community? Also consider if there are any unique barriers to lending such as a university or prison—both have populations who are unlikely to seek mortgage or small business loans.

Performance context should also consider the availability of opportunities to provide community development activities in your assessment areas. Most major metropolitan areas have a significant number of CRA opportunities; however, competition for those opportunities could be high. In smaller communities, there could be a lack of organizations, programs, or investments that restrict the bank's ability to support the community. In some rural areas, a lack of community development infrastructure may exist, meaning the bank could be attempting to serve a CRA desert. During examinations, regulators will reach out and discuss community needs with local government and nonprofit leaders to determine overall community needs. Banks may want to have similar discussions with their community partners to identify areas of opportunity or lack thereof.

Building the Narrative

Once you've researched your assessment areas and identified the data that best illustrates your bank's overall performance, you need to take the next step and organize the data into a format that narrates the bank's CRA story. Having the data is one thing but presenting it as raw data is not enough.

An impactful bank-prepared Performance Context will provide insight into the bank's levels of lending, investment and services supported by and compared to the information collected during Performance Context research. Handing your examiners a stack of economic data in one folder with CRA activity reports and tracking sheets in another folder is

a missed opportunity to craft a clear picture of how Performance Context factors explain the bank's overall CRA successes and apparent deficiencies.

Banks that are successful with preparing their own Performance Context regularly compare external data to internal standards and performance to ensure that sufficient detail is provided regarding market conditions and factors. They weave together a compelling narrative of how the bank is but one entity in a larger economy and highlight the ways their bank is addressing identified community needs and seizing opportunities as they arise. Good performance context also identifies areas where the bank has underperformed and provides explanations for that underperformance.

While it may seem daunting to prepare performance context for the first time, every bank that I have met that invests in doing so has seen the benefit during examinations. Ultimately, no one can tell your bank's CRA story better than you. ■

ABOUT THE AUTHOR



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