STRATMOR GROUP

In-Focus

CRA LENDING — BANK PERSPECTIVES TODAY AND IDEAS FOR TOMORROW

AN EXCERPT FROM
STRATMOR INSIGHTS

Volume 3, Issue 11
November, 2018

CRA LENDING — BANK PERSPECTIVES TODAY AND IDEAS FOR TOMORROW

By Tom Finnegan, Principal

It has been six months since President Trump signed the bill that gave banks relief from Dodd-Frank regulations. And, it has been just three months since the OCC (Office of the Comptroller of the Currency) released an Advanced Notice of Proposed Rulemaking (ANPR) requesting comment on a proposed update of the Community Reinvestment Act (CRA). What will the next few months bring?

2018 is moving through the fourth quarter and bank lenders are looking at Washington with increased optimism as some regulatory requirements are being relaxed, especially for smaller institutions. Even so, it is unlikely that banks will rush to liberalize credit standards in their programs and products, let alone revert to pre-2008-crisis lending practices — compliance with lending requirements of the CRA is still a very important part of bank mortgage lending.

This view is backed-up by the findings of a recent STRATMOR survey of bank lenders on their views concerning the current requirements of the CRA, about how they go about meeting those requirements and what they would like to see retained or changed in any update of the Act. Ninety-five percent of the banks that participated in this survey indicated that they have a strong internal focus on the CRA, as well as formal governance structures to assure compliance.

CRA LENDING — BANK PERSPECTIVES TODAY AND IDEAS FOR TOMORROW

Here are six additional interesting perspectives on CRA lending and compliance from the responding banks.

1. Surprise — The Majority of Responding Banks Believe that CRA Lending is Profitable

We often hear that loans to low and moderate income (LMI) borrowers and in LMI areas are a loss leader and that banks can't make money serving these customers. In our survey, however, 61 percent of the respondents said their CRA/LMI lending is profitable, most without inclusion of any net interest income from retaining ownership of some CRA loans in the bank's mortgage portfolio. A very high percentage of responding lenders originate FHA and VA mortgages as well as low down payment conventional mortgages. Since government loans can be especially profitable to originate, this type of production is likely contributing to the opinion being expressed.

2. Banks Know that Goal Setting and Focus Are Important to Success in CRA/LMI Lending

A key question Bank CEOs have about CRA/LMI lending is how best to manage origination activities. Are their competitors' Loan Officers (LOs) required to do LMI/CRA lending as part of their overall volume goals? How are LO's splitting their time between standard LO functions and outreach activities aimed at better connecting with and serving the community? How are they compensated for participating in community activities that hopefully generate leads?

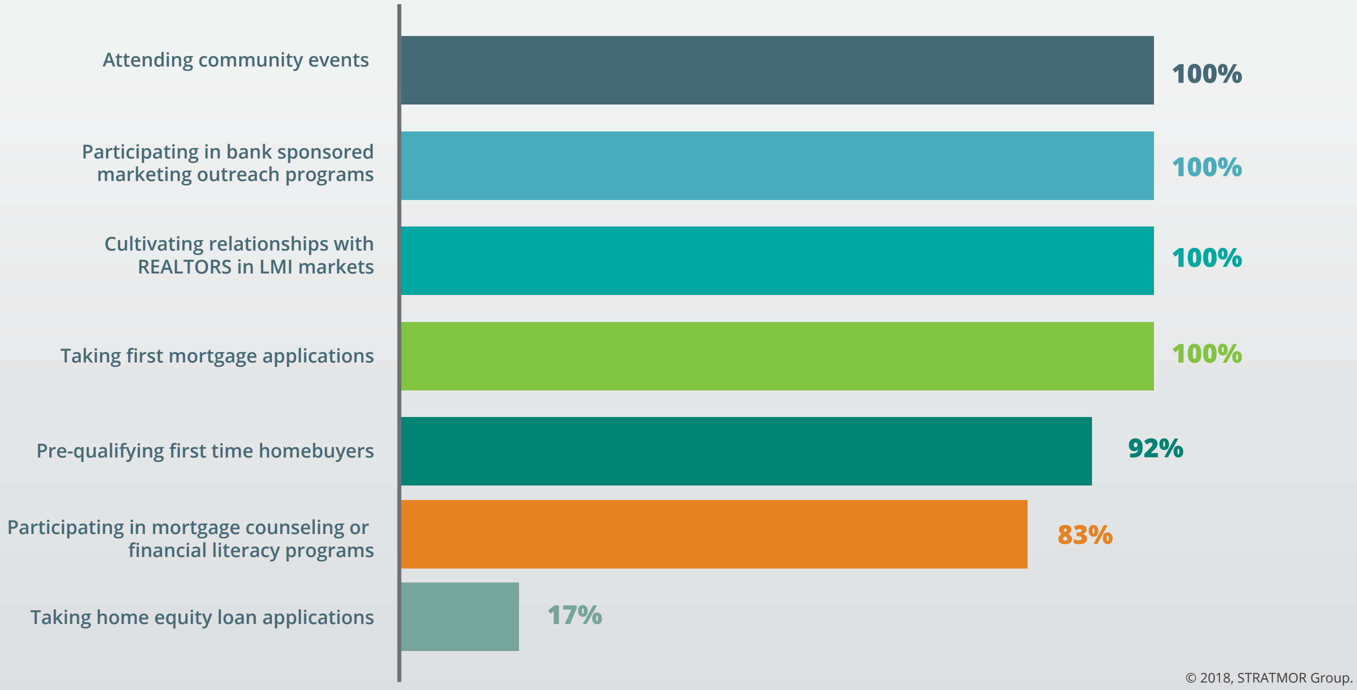
The survey indicates that LMI loan origination is an "all-hands-on-deck" activity for most banks. Sixty-three percent of respondents ask their total LO sales force to participate in CRA/LMI origination via the establishment of goals for these loans. At the same time, more than half have a separate, dedicated group of sales people who focus specifically on CRA/LMI originations. For all but one respondent bank, the CRA/LMI LOs report to mortgage sales management. These targeted CRA LOs represent, on average, 8.6 percent of the overall LO sales force for the respondents that have a separate, dedicated group. This reporting line structure indicates that banks believe the disciplines associated with focused mortgage sales management are important to success in LMI/CRA lending as well.

As would be expected, goals are expressed in terms of volume to LMI borrowers and in LMI census tracts, but two-thirds of the respondents now also include volume to minority borrowers and in "majority-minority" census tracts in their goal setting. This may reflect an emerging emphasis on these metrics by regulators.

3. There's More to Originating CRA Loans Than Taking Applications

Chart 1

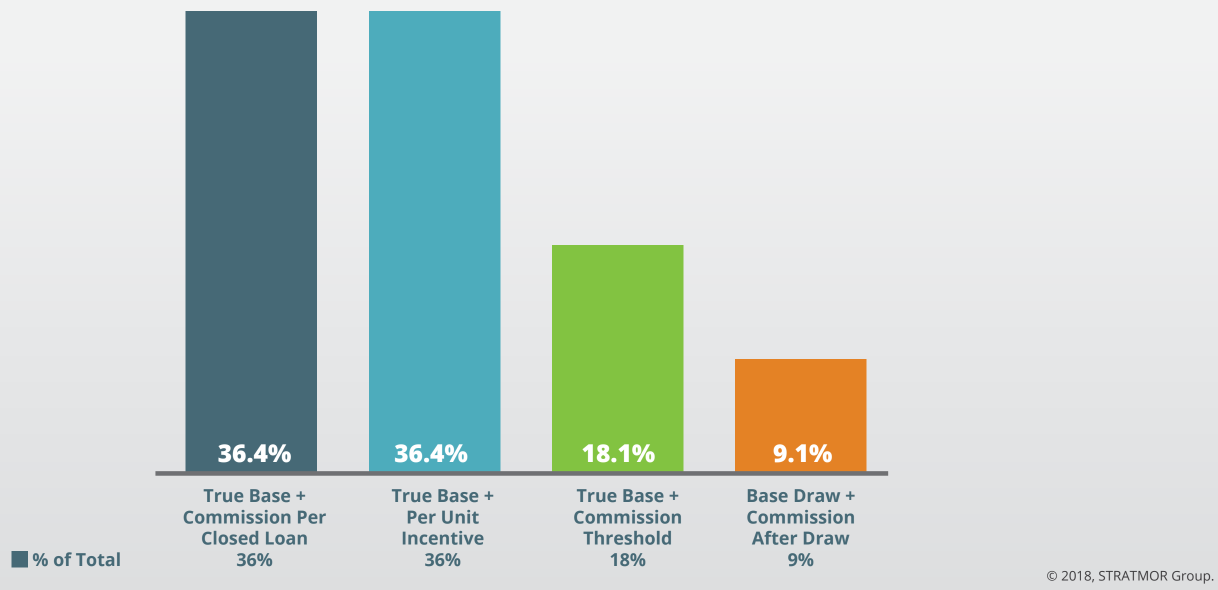
What is included in the CRA/LMI LO Job Description



Clearly, banks believe that their dedicated CRA/LMI LOs have responsibilities in community outreach, including activities such as participating in financial literacy programs and community events as components of their lending activities. That said, and as shown in the tables which follow, the lack of non-volume factors as components of variable compensation is a somewhat surprising finding given the broad business development tasks assigned to these specialist LOs. Most compensation plans appear to use only volume-based commissions to drive LO variable compensation.

Chart 2

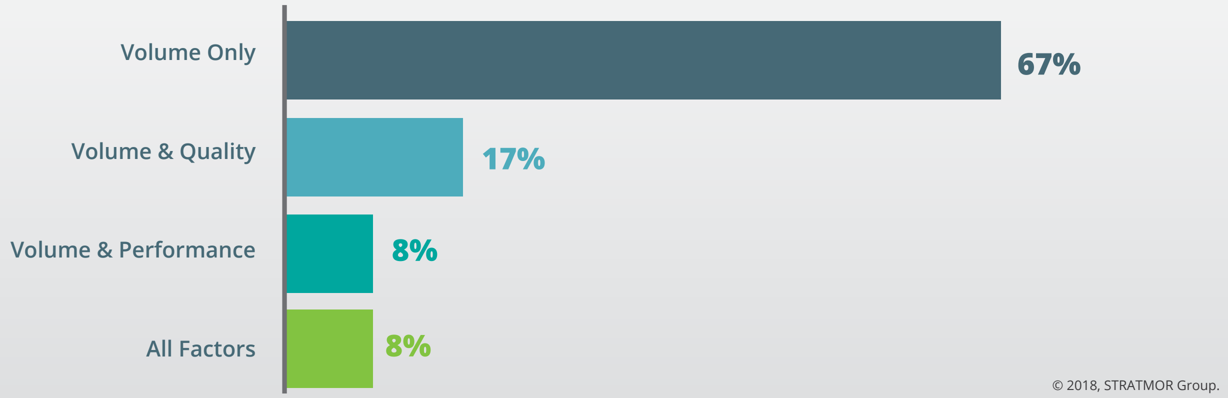
Compensation Structure for CRA/LMI Loan Officers



With respect to compensation structure (Chart 2), the predominant approach for specialist CRA/LMI LOs is to provide a base salary augmented by commission on closed loans, rather than a pure commission-only structure. Fifty-eight percent of respondents have a minimum commission for lower balance loans that allows both specialist and traditional LOs the freedom to pursue LMI loans without undue concern about the commission level due to smaller loan sizes. Presumably, the salary portion of compensation in the prevailing structure is used to cover the other business development and community outreach responsibilities of the position, but more direct compensation benefits from performing important community development activities appears to be an area which banks could better address — as shown in the chart below, only 16 percent of banks introduce performance factors beyond volume or quality into the variable compensation mix.

Chart 3

Factors in Commission Calculations



4. Retaining Servicing Helps Banks Stay in Touch

Most banks sell a very large percentage of their CRA/LMI originations in the secondary markets, meaning that standard products are predominantly used to meet these obligations, although 61 percent of respondents do have proprietary portfolio products available to help meet their CRA goals. For loans being sold, 70 percent of respondent LMI loans are sold "servicing retained", creating an ongoing relationship with the LMI customer on these loans as well as on portfolio originations. This interesting finding indicates that banks believe it is important to stay in touch with these customers and that the community-oriented aspects of having the bank's personnel involved throughout the loan's life — providing advice, taking payments at branch locations and dealing with borrower life situations in a hands-on manner, etc. — are important tools in winning this business.

5. Another Surprise: The Majority of Responding-Banks Don't Have a Specific CRA/LMI Marketing Budget

More than half of respondents indicated they have no specific CRA/LMI marketing budget, which is surprising given the level of focus on this area indicated throughout the survey. This may be due to a view that bank institutional advertising is a key component of LMI marketing; however, this fact appears to be inconsistent with overall bank goals for CRA compliance and may be an area for many banks to improve. Typically, marketing activities are a shared responsibility between the mortgage lending group and corporate marketing.

6. Most Responding Banks Believe that CRA Changes are Needed, Including the Lending Test Component

The regulators and Congress are currently debating possible changes to the CRA. Two-thirds of the respondents agreed that changes are needed, and 90 percent believe that it will be harder or substantially harder to meet CRA/LMI lending goals in the next 24 months. Comments from participating banks emphasized the continuing need for the Act to focus on lending in the communities served by the bank, but that other aspects of the bank's mortgage lending business outside of its CRA delineated communities should not be impacted by the level of lending inside those communities. In other words, each should stand or fall on its own.

Also, comments were received that the evaluation of lending performance under the Act should consider the competitive environment in a bank's delineated communities and how the level of competition could impact closed loan volume performance. Most banks use selected purchases of closed loans to help meet CRA requirements, but suggested changes included providing a better definition of how loan purchases will be treated in terms of CRA compliance.

Where Does the Survey Data Lead Us?

Banks are dedicating significant resources to serving LMI borrowers and communities and need the CRA to be responsive to today's technology driven mortgage lending environment. They believe that:

- CRA and LMI lending can be profitable
- The CRA should focus on meeting community mortgage lending needs, but not penalize other mortgage lending business that a Bank may elect to do outside of its deposit gathering communities
- The Act should be clearer on how purchases of loans can support CRA objectives, and that the competitive environment for mortgage lending should be considered in determining CRA compliance
- Efforts in the area of financial education and counseling should be recognized as an important part of meeting CRA goals

Banks want changes to the CRA lending test made with the underlying goal clearly in mind — encourage the extension of mortgage credit that advances sustainable homeownership for their customers and in their communities.

STRATMOR CAN HELP YOU MEET THESE CHALLENGES

We would like to hear more from you about how the CRA can be modified to be more effective, and about successful initiatives that have helped your bank meet CRA challenges. STRATMOR is actively working with banks across the country on mortgage strategy, operations and profitability. If you would like to improve results from your CRA and LMI marketing and outreach, take a deeper dive into functional profitability, or review your Loan Officer Compensation plans for improved CRA and overall performance and results, please contact Principal Tom Finnegan at tom.finnegan@stratmorgroup.com or 614-638-3795.