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Understanding Community Development Needs through the CRA Performance Context

Laura Choi and William Dowling

December 2014
Working Paper 2014-02
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INTRODUCTION

Tolstoy may be an unlikely source of community development insight, but the opening line from *Anna Karenina* speaks deeply to the nature of struggling communities today: “Happy families are all alike; every unhappy family is unhappy in its own way." While thriving communities all possess the full set of prerequisite characteristics for success, such as effective leadership, robust economic activity, and educational opportunity, the absence of any one of the multiple conditions required for “happiness” erodes a community’s strength. Unfortunately, many struggling communities are marked by the absence of a number of these conditions. While many low- and moderate-income (LMI) neighborhoods exhibit similar characteristics, such as high poverty and unemployment or low educational attainment, the distinctiveness of the challenges that drive these outcomes is often overlooked. To borrow the line from Tolstoy, each LMI community is “unhappy in its own way.”

As such, community development efforts to revitalize LMI neighborhoods should begin with an appropriate understanding of the needs and opportunities present within these communities. This sentiment is especially true of banks looking to fulfill their Community Reinvestment Act (CRA) obligations. A truly responsive and innovative CRA program should begin with the “performance context,” or knowledge about the bank’s local markets, including the needs of the community as well as the opportunities that exist within the local network of resources and organizations. In the same way, bank examiners must also understand the local context in which financial institutions are operating in order to appropriately assess a bank’s CRA activities. While such data gathering and analysis may seem daunting for both bankers and examiners alike, the process can be broken down and simplified in many ways. Additionally, there are emerging opportunities to leverage technology and partnerships to bring innovation to the performance context process.

Despite its centrality to the CRA exam, there is very little written about the performance context, perhaps because it seems deceptively straightforward. However, interviews with examiners and bankers, conducted as part of our research, suggest that both sides struggle with developing a robust understanding of local conditions and needs. In this paper, we attempt to demystify the CRA performance context and establish its strategic value. This paper explores new opportunities for strengthening the performance context as a community development tool, from the perspective of both bankers and regulators. Throughout the paper, we include commentary from various individuals with CRA expertise to provide a range of perspectives on the performance context.

CRA AND THE PERFORMANCE CONTEXT

The CRA, enacted in 1977, encourages depository institutions to help meet the credit needs of the communities in which they operate, including LMI neighborhoods, consistent with safe and sound operations.[1] By design, the regulation does not uphold hard and fast rules or ratios for CRA compliance, but rather encourages flexibility and customization. The regulation recognizes that a bank's activities will vary by geography, based on the unique economic and community development conditions of the local community.

WHAT IS THE PERFORMANCE CONTEXT?[2]

The performance context is the "broad range of economic, demographic, and institution- and community-specific information that an examiner reviews to understand the context in which an institution's record of performance should be evaluated."[3] In practice, the performance context is a research-based narrative that describes the environment in which the bank is conducting its CRA activities. Each bank and market is different, so the performance context allows examiners to qualify the local conditions and capacity that contribute to a bank's CRA activities. This allows examiners to enforce the CRA regulations in a consistent manner across institutions and markets.

In practice, the factors informing the evaluation of a bank's performance typically include:

- ***The financial institution's*** size, financial condition, capacity, business strategy, product offerings, economic climate, performance of peer institutions, regulatory restrictions, and past performance, including any public comments related to the bank's performance;
- ***The community's*** needs, including lending, investment and service opportunities, demographics, economic and employment conditions, small business climate, housing market, and community plan.

These factors are captured through a combination of quantitative and qualitative data, both of which are vitally important for developing a comprehensive understanding of local markets. While there may be a temptation to approach the task by simply compiling easily accessed quantitative data, this approach fails to capture the nuance of the underlying factors that drive that data. As such, examiners rely on interviews with "community contacts" that can provide details on the local community, such as

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[1] To learn more about the CRA, visit the Federal Financial Institutions Examination Council CRA resources page at http://www.ffiec.gov/cra/

[2] This section was informed by the panel "Understanding Community Development Needs through the Performance Context" held during the 2014 National Interagency Community Reinvestment Conference.

[3] Interagency Questions & Answers Regarding Community Reinvestment, §ll.21(b)—1. Federal Register, Vol. 75, No. 47, March 11, 2010. Available at http://www.ffiec.gov/Cra/pdf/2010-4903.pdf

information on opportunities for bank participation or perceptions on the local performance of financial institutions.

It is the responsibility of the examiners to conduct the research related to the performance context prior to the start of an exam. The official performance context narrative that becomes part of the bank's publicly available Performance Evaluation is thus completed by the regulatory agencies. Banks may conduct their own performance contexts and submit them to their examiners for consideration, but are not required to do so. However, as we will discuss below, there is significant strategic value for financial institutions to conduct their own performance context research.

WHY DOES THE PERFORMANCE CONTEXT MATTER?

Community development does not happen in a vacuum, and neither should a bank's CRA exam. In order to appropriately assess a bank's CRA activities, examiners must begin with information about the bank and its assessment areas. This information helps examiners understand why certain activities were undertaken, as well as the challenges that may have limited CRA activity in specific areas. Similarly, banks must have an adequate understanding of their own markets in order to effectively target their CRA programs for the dual purposes of achieving impact and satisfactorily meeting their regulatory obligations. The performance context is thus an important tool for both regulators and bankers. While the process of writing the performance context will vary across institutions, the end result should be consistent, namely, a research-based understanding of the credit and community development needs and opportunities present within a bank's assessment areas.

An important point regarding the performance context is the issue of timing. The CRA exam process is inherently backwards-looking. Examiners assess the bank's activities during the review period, which is typically the past 24 to 36 months. The examiner's performance context is thus retrospective. However, a banker conducting his or her own performance context should be gathering information in real-time in order to develop a forward-looking strategic plan that is responsive to local needs and opportunities. The bank's *prospective* performance context thus lays the foundation for the design of its CRA program, while the examiner's *retrospective* performance context provides the basis for the evaluation of that program. These two approaches likely tell two stories that overlap, but the information should not be identical.

"It's about strategic and creative thinking at the front end, rather than doing the performance context after the fact and then merely using it to justify what you did and why, even when what you did wasn't what the community needed," said Carolina Reid, an Assistant Professor in City & Regional Planning at the University of California Berkeley who has done extensive CRA-related research.

BANK REGULATORS AND THE PERFORMANCE CONTEXT

From the examiner's perspective, the performance context provides the analysis that helps explain the broad economic and demographic conditions of a bank's given market. The bulk of this information typically comes from publicly available quantitative data sources, such as the U.S. Census Bureau or the Bureau of Labor Statistics.[4] While this information is useful for setting the context of the macroeconomic environment in which the bank is operating, it fails to capture the nuance of specific community development needs and the capacity of local organizations to meet those needs. Community contact interviews provide some "on the ground" information, but respondents typically focus on a single subject of which they have deep knowledge, such as affordable housing or small business. Banks thus have an opportunity to look across their markets and help examiners gain a more comprehensive understanding of local needs and opportunities. Jessica Farr, a Manager of Examinations with the Federal Reserve Bank of Atlanta, comments on what she considers when writing a bank's performance context below.

Use of the Performance Context for a CRA Exam

Jessica Farr, Manager of Examinations, Federal Reserve Bank of Atlanta

A bank's CRA performance is evaluated relative to defined geographic assessment areas (those markets where the bank has an established branch presence). Examiners consider the bank's lending performance relative to demographic data and the aggregate of all lenders in the market. We consider the bank's community development lending, investments and services using both quantitative and qualitative factors. In addition to evaluating the volume of the bank's activities relative to the bank's presence in the market, we look closely to see if what the bank is doing is responsive to identified community credit and community development needs and whether the bank has demonstrated leadership in addressing these needs.

However, examiners have a hard time always identifying community credit needs and community development opportunities because they lack the grassroots knowledge that a bank should have due to their presence in the local markets. Therefore, it's critical that the bank think of the performance context as a chance to tell their "story" about how the bank has developed a CRA strategy, in light of its size, resources, and opportunities.

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[4] For more information about community development data sources, see the *Community Development Data Guidebook* http://www.frbsf.org/community-development/files/Community-Development-Data-Guidebook.pdf

In developing a performance context, here are examples of questions to consider:

- How does the bank assess community needs and identify community development opportunities and partners?
- What type of credit products does the bank offer to meet the needs of first time homebuyers, credit-impaired borrowers and small business customers? Are any of these products considered innovative or particularly responsive to local economic needs and conditions?
- What type of outreach does the bank do to reach small business segments and underserved communities?
- What is the bank's role in housing or community development programs in the market? Has the bank taken a leadership role in terms of investing or service hours?
- What does the bank consider to be the most high-impact projects in its community development portfolio?
- Is the bank supporting alternative financing sources, such as CDFIs?
- What is the bank doing to address community revitalization/stabilization in the community, particularly areas still recovering from the recession?
- What is the bank doing to promote access to banking for underserved consumers? Has the bank developed new products or mechanisms for delivery services? What metrics does the bank gather to show the impact of alternative delivery services in meeting the needs of LMI consumers?
- Who are the bank's competitors? What are they doing around CRA and how are they doing it?

Unlike other consumer compliance regulations, evaluating CRA performance is considered an art and a science. As the financial services and community development landscape changes, emphasis is shifting more towards the art and away from the science. It's no longer just about the volume of activities but about the impact of those activities in the bank's communities. The performance context is the foundation for the evolving CRA performance evaluation.

AN INNOVATIVE PERFORMANCE CONTEXT PARTNERSHIP

As mentioned previously, the onus of developing the performance context for purposes of the CRA exam falls upon the bank regulators. While examiners are highly skilled in analyzing and assessing a bank's performance, they typically do not have a background in community development research. In many ways, the challenge of synthesizing a broad array of economic and community data for the performance context narrative requires an entirely different skill set than most examiners possess. Thus, while regulators are certainly able to fulfill this task, this "skills mismatch" can create inefficiencies. As one consumer compliance examiner put it, "The problem is that collecting the information and piecing it together in a meaningful way is very, very time consuming—especially for people (like me) who do it infrequently. There must be a more efficient way to do it… Because I am not a researcher, I don't have tricks or techniques for finding the information I need." This is further complicated by the fact that different individuals write the performance contexts for different exams. This creates inefficiencies as multiple people may be writing individual performance contexts for overlapping assessment areas across banks. In addition, the decentralization of the performance context writing process also means that different individuals are likely accessing different data sources, which may create a lack of consistency across exams.

Given these challenges, there are opportunities for performance context innovation. One such example is a recently formalized partnership between the Bank Supervision and Regulation (BSR) and Community Development (CD) departments of the Federal Reserve Bank of San Francisco. As a result of the partnership, a full-time researcher from CD is dedicated to developing the performance contexts for all CRA exams conducted within the Federal Reserve's 12th District. While formally housed within the CD department, this researcher works closely with consumer compliance examiners from BSR and effectively bridges the two departments. By being embedded in the CD department, the researcher stays deeply connected to the relevant data and emerging trends within the community development field. This also allows the researcher to draw on important CD publications, such as "Vantage Point," a community indicators survey covering the 12th District,[5] and leverage the department's five outreach managers who are based in different locations throughout the District and have a well-established network of local community development contacts. These resources are especially important for shoring up the relatively limited perspective currently provided by "community contact" interviews.

By centralizing the performance context function within a single research position, this partnership has also created consistency across exams in terms of data sources and analysis, making it easier to do bank-to-bank or year-to-year comparisons. But perhaps the most exciting aspect of this partnership is the ability to help inform BSR examiners on the changes that are taking place in the community development field. As new cross-sector models and innovative financing vehicles begin to unfold in the field, it's important for examiners to understand these trends and how they affect banks' CRA activities and opportunities. This partnership has broken down the departmental silos that previously existed between BSR and CD, despite the fact that both groups were working on CRA-related issues. While this model is unique to the SF Fed, it provides an example of the types of partnerships that could be mutually beneficial when it comes to CRA and community development.

[5] http://www.frbsf.org/community-development/publications/vantage-point/

BANKS AND THE PERFORMANCE CONTEXT

From the banker's perspective, the performance context is a regional assessment of the economic and community development conditions in which an institution operates. While not required, banks are highly encouraged to develop a robust performance context in order to identify credit needs and potential opportunities for involvement within their markets. As mentioned previously, the spirit of this assessment differs from a regulator's in that it is used to plan for future bank activities, not to evaluate past ones. This allows a bank to tie its CRA activities to a larger strategic plan and ensure that these activities are not just the "checking of a box." The importance of this approach is underscored in the Supplementary Interagency Questions and Answers Regarding Community Reinvestment, in which the three regulatory agencies note:

> *The context in which an institution's CRA performance occurs is important. Performance context is always considered when evaluating an institution's record of helping to meet credit needs under CRA. The needs and opportunities of an assessment area may vary depending on the area and the financial institution. It is important, therefore, for an institution to be aware of the community development needs and opportunities in its assessment area(s) and to determine whether, and to what extent, the institution has the capacity and expertise to address such needs and opportunities.*[6]

A successful performance context not only identifies the needs in a bank's assessment areas, it determines which needs are within a bank's capacity to address. The performance context is as much a self-assessment as it is a regional assessment and, as such, banks should continuously evaluate their activities against both the community development environment in their markets and their own business models. A truly successful CRA program should be both nimble enough to recognize the importance of new market data and responsive enough to act upon that data.

By comprehensively evaluating its assessment areas, an institution is also able to determine whether or not there may be opportunities for involvement in the broader statewide or regional area, that includes the institution's assessment areas, but that may not directly benefit these assessment areas. Per the aforementioned guidance, "examiners will consider these activities even if they will not benefit the institution's assessment area(s), as long as the institution has been responsive to community development needs and opportunities in its assessment area(s)."[7] This allows an institution to maximize its area of impact and look for opportunities outside of what may be well-served markets. A strong performance context is the key to determining whether or not an institution has been responsive to

[6] Interagency Questions & Answers Regarding Community Reinvestment, commentary regarding Q&A §.12(h)–6, Federal Register, Vol. 78, No. 224, November 20, 2013. Available at http://www.gpo.gov/fdsys/pkg/FR-2013-11-20/pdf/2013-27738.pdf
[7] Ibid.

needs within its primary assessment areas, and good data is the key to that context. Some of the data sources used by bankers will likely overlap with those utilized by bank examiners; however, bankers should inherently look at data in a prospective manner. Due to the timing lag that can exist with some data sources (e.g. data from the American Community Survey is always at least a year old), bankers should be creative in the way in which they gather and analyze information. In addition to traditional quantitative analysis, contact with community stakeholders can serve as an invaluable source of qualitative information and help supplement gaps in data. Individuals working in sectors like affordable housing or small business lending can not only provide information about their communities, but also serve as potential partners to banks. Many CRA officers have commented on the benefit of establishing lasting relationships with non-profits in their assessment areas to identify and address community development needs together.

WHERE TO START

For those banks who have never written a performance context, it can be challenging to determine where to begin. Fortunately, there are resources available that can aid in the process,[8] and the more a banker researches community development needs, the better he or she will get at identifying trends and potential areas of impact. Beth Trotter, Senior Vice President and CRA Officer of IBERIABANK, based in Louisiana, shares a few helpful tips below:

The Logistics of a Strong Performance Context

Beth Trotter, CRA Officer, IBERIABANK

Banks have an important opportunity to craft their own CRA Performance Context documents for use in connection with an exam. A few critical focus areas are:

Communication with Markets

- Ideally, a bank should tap CRA Market Liaisons in every market; these associates usually have other jobs but also "wear a CRA hat" with dotted line reporting to the CRA department. It is important to hold monthly calls with these liaisons to discuss new initiatives, community needs, annual targets and progress toward goals.
- Liaisons should seek out community development opportunities which peers have not identified; unique or underused services should be identified.
- CRA efforts should be an integral part of the bank's business outreach; performance context summarizes what your institution and employees do as an extension of your bank's business model.

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[8] For information about community development data sources and an example of a performance context, see: http://www.frbsf.org/community-development/files/Community-Development-Data-Guidebook.pdf To download the performance evaluations of regulated banks, visit: http://www.ffiec.gov/craratings/default.aspx

Process of Gathering CRA Information and Drafting the Performance Context

- A bank's impact in each assessment area (AA) should be tracked with the assistance of the CRA liaisons. Collection of information regarding community needs and outreach efforts at an AA level needs to occur regularly.
- Detailed, up to date tracking sheets afford your bank the ability to gauge community needs quickly and adjust bank strategies accordingly, including consideration of unique aspects of each AA.
- Precise and regular tracking also allows for detailed documentation of all CRA-related activities in every AA, almost at a branch level, on a monthly basis.
- A good data capture system is imperative; create detailed automated forms on the internal bank website for all associates' use in reporting CD service hours, donations, and loans.

Performance Context as an Internal Tool

- Continuous interaction and communication with CRA Market Liaisons facilitates the identification of community needs as well as strong nonprofit partners which are positively impacting those needs in each AA.
- The Board and Executive team, as well as business unit owners, can easily review and assess CRA performance by state and by AA.
- Distribution of the performance context to each AA's leadership team allows for meaningful conversation regarding which partnerships are working and where there are gaps in CRA performance which need to be addressed.

Final Thoughts

- Your performance context should highlight examples of employees working as a team in each market to increase capacity of the institution by positively impacting communities.
- The actual process of drafting the document raises awareness of associates in all markets regarding community needs and the planning of CRA initiatives around those needs.

While a strong performance context should be thorough, drafting it does not necessarily have to be time intensive. As noted above, those involved in conducting performance context research often have other responsibilities, but keep the institution's CRA plan in mind while fulfilling those responsibilities. There may also be opportunities to partner with other banks and area non-profits when conducting research, to create even more efficiencies. As one example of such a partnership, lenders in Utah have successfully organized a steering committee with other lenders in their market to identify community development needs collectively. This committee not only maximizes resources, but brings additional partners to the table and allows for a collaborative approach to addressing area credit needs.

CONLSUSION

Revisiting and prioritizing the performance context can have transformative effects on the CRA exam processes. For regulators, it establishes a rich economic and community development backdrop by which to systematically assess a bank's CRA activities and offer recommendations for future activities. For banks, it better aligns CRA actions with the needs of the communities they serve. As the performance context continues to evolve, it will open up even more occasions for shared research and joint collaboration between examiners, bankers, and others with a vested interest in their communities. For a regulation that can often seem rote and procedural, the CRA performance context affords an opportunity to highlight the diversity of needs and opportunities that exist in communities throughout the country.