

CAPCO

COMMUNITY REINVESTMENT ACT

NOT JUST FOR BANKS ANYMORE



a wipro company

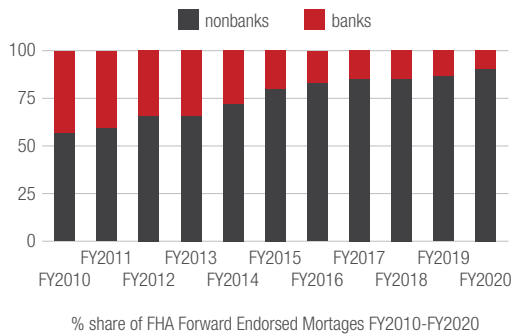
INTRODUCTION

Within the last decade, non-depository lending institutions (e.g., independent mortgage banks (IMBs)) have taken over the majority share of mortgage originations in the U.S. and continue widening the gap compared to depository banks. Given this fundamental

shift in market share, it is no surprise that calls for increased consumer protection are on the rise for IMBs to ensure a level regulatory playing field between banks and IMBs.

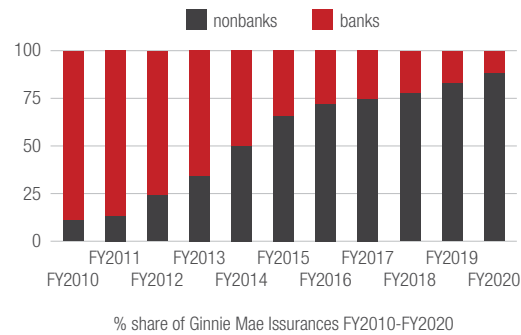
IMB share of the FHA market¹

Nonbank share of FHA mortgages rose from 57% to 90% over past decade, as banks left the market



IMB share of the Ginnie Mae market¹

Ginnie Mae Issurances by nonbanks have skyrocketed from 12% to 87% of total during past decade



IMBs are already responsible for a broad span of consumer protection regulations at federal, state, and agency levels, including fair lending laws which govern all lenders. The only exception is the Community Reinvestment Act (CRA). This federal law was initially designed to govern depository institutions and, since its inception in 1977, has not been applied broadly to IMBs, until now.

There is a broad consensus that this 45-year-old law needs to be updated to account for how consumers bank and borrow today,

and such an effort was launched in 2017 by the U.S. Treasury Department.² However, with supervisory and enforcement split among three federal agencies, that process is inherently more complex. Now, a few years later, with CRA modernization stalled at the federal level, 2021 saw two key states take action to affix protections at the state level subjecting nonbank mortgage lenders to a variety of CRA requirements. Although only a few states have taken these steps to expand CRA accountability, the potential impact to IMBs cannot be overstated.

1. CHLA IMB Report. (2021). Retrieved from <https://www.communitylender.org/wp-content/uploads/2021/06/CHLA-IMB-REPORT-June-2021-.pdf>

2. 4-3-18 CRA Memo; (2018, April); retrieved from US Treasury Department <https://home.treasury.gov/sites/default/files/2018-04/4-3-18%20CRA%20memo.pdf>

In the past year, Illinois and New York have joined the state of Massachusetts, whose CRA oversight has included IMBs since 2007.³ While final rulemaking is still underway for both Illinois and New York, their initial framework mirrors that of Massachusetts, which mandates CRA compliance to all mortgage lenders originating greater than 50 loans within the state in the previous calendar year based on HMDA reported data.⁴ Each of these states will now lawfully supervise and enforce CRA regulatory performance for such lenders.

The lender's satisfactory performance will be required to receive approval for:

- New or renewing state licenses
- Opening and closing of offices or mobile/electronic branches
- Mergers or acquisitions⁵

Given the expanse of potential compliance, operational and reputational impact, IMBs must be proactive and thoughtful in developing a CRA compliance strategy. Beyond the impact, CRA compliance is not an easy problem to solve. It is imperative that IMBs take a sophisticated approach to developing a CRA Compliance strategy and consider several key factors.

CRA IS CONSIDERED A FAIR LENDING LAW, BUT IT DOESN'T FIT INTO THE FAIR LENDING GOVERNANCE THAT IMBS CURRENTLY HAVE IN PLACE

It is important to understand that both CRA and fair lending performance are assessed within these new state-level exams. It is also important to understand the differences between these laws and how those differences affect the development of a CRA-specific compliance strategy. Fair lending laws protect applicants from discriminatory treatment and effects based on protected classes which include race, color, religion, national origin, ethnic origin, sex, marital status, age, sexual orientation, physical impairments, and source of income via public assistance.⁶ CRA, on the other hand, was enacted to ensure

banks reinvest and lend to low- and moderate-income (LMI) individuals and geographies, as well as serve the financial needs of distressed and underserved areas within the markets in which they operate.⁷ **These are distinctly different metrics which require distinctly different strategies.**

Most components of the CRA performance examination will be uncharted territory for IMBs. The examination is made up of three separately rated tests: a lending test, a service test, and an investment test.⁸ The exam includes a review of fair lending

3. NCRC. (2021, July 27). Massachusetts CRA For Mortgage Companies: A Good Starting Point for Federal Policy. Retrieved from ncrc.org: <https://ncrc.org/massachusetts-cra-for-mortgage-companies-a-good-starting-point-for-federal-policy/>
4. Community Reinvestment Act (CRA) for banks and credit unions. (2021). Retrieved from Mass.gov: <https://www.mass.gov/info-details/community-reinvestment-act-cra-for-banks-and-credit-unions#examination-process->
5. Mortgage Lender Community Investment (CRA for mortgage lenders). (2021). Retrieved from Mass.gov: <https://www.mass.gov/info-details/mortgage-lender-community-investment-cra-for-mortgage-lenders>
6. Community Reinvestment Act (CRA) for banks and credit unions. (2021). Retrieved from Mass.gov: <https://www.mass.gov/info-details/community-reinvestment-act-cra-for-banks-and-credit-unions#examination-process->
7. Community Reinvestment Act (CRA). (2021). Retrieved from Federal Reserve.gov: https://www.federalreserve.gov/consumerscommunities/cra_about.htm
8. Willis, M. (2021). Revisiting the CRA: Perspectives on the Future of the Community Reinvestment Act. Retrieved from frbsf.org: https://www.frbsf.org/community-development/files/its_rating_stupid1.pdf

practices and performance. At minimum, IMBs should already have framework in place to track and monitor HMDA data, which aids in the creation of fair lending metrics. And while this data set includes tracking for loan applications associated with majority-minority designated geographies, it now needs to be expanded to capture loan applications for LMI applicants and

geographies. Beyond these basic metrics, IMBs will need to add extensive quality assurance measures to test its products, processes and portfolio for innovation and flexibility, tracking affordable housing units, as well as extensive loss mitigation review and metrics.

CRA REQUIRES A MULTI-PRONGED STRATEGY FOR COMMUNITY DEVELOPMENT

Community development is measured within all three testing components of the CRA exam: lending, service, and investment testing. This requires IMBs to think well beyond consumer data that can be sourced from loan applications. IMBs must:

- Understand what qualifies as community development
- Be able to associate activity to LMI applicants/geographies, as well as federally designated distressed and underserved geographies
- Be able to document a business case or justification for “why” it qualifies

IMBs must also consider that tracking service requires training employees at all levels to adopt, conduct, identify, and report community development service properly. Additionally, tracking service requires a platform or database to capture dates, personnel involved, receipts, and other supporting documentation for qualification justification.

DEVELOPING A CRA COMPLIANCE STRATEGY IS A MAJOR TRANSFORMATION

Creating a successful CRA compliance strategy involves complex layers of change across the organization. Moreover, the fulfillment of the strategy is the responsibility of every employee. As a result, the vast majority of financial institutions employ a dedicated team of compliance and business development experts to plan, manage, and execute the day-to-day responsibilities for maintaining CRA compliance.

Developing the program framework to support the compliance strategy is equally complex and time intensive. It requires analyzing people, process, technology, and workflows to identify, strategize, and implement necessary changes. Additionally, IMBs must develop strategies to identify, monitor and mitigate risks across those factors. This requires consistent understanding and prioritization across all lines of business.

Additional consideration should be given to the resources required to compile CRA compliance goals and requirements, as well as the specialization and expertise necessary to provide quality assurance in preparation for inquiries from regulators. This level of transformation calls for a change management strategy to

account for full impact, engagement, communication, training, and adoption across the organization. IMBs must carefully craft a plan for change implementation to guide their organization, employees, and customers through these necessary changes.

FORMULATING A PERFORMANCE CONTEXT IS NOT “ONE AND DONE”

IMBs will also need to formulate a performance context for CRA. This involves a detailed understanding of the markets, economic climate, opportunities, peer performance, and justification for strategy. This is no small feat, as it requires extensive dedicated resources and broad external data. Additionally, those factors change often, so it requires routine updates to adjust for those changes.

This is a critical but often overlooked element of the CRA compliance strategy, but it should not be. The performance context is the lens through which regulators view the measurable efforts and performance of an IMB. IMBs should take great care in formulating its content and messaging as it is not enough for an organization to understand its own performance and to substantiate its approach for obtaining it. It must clearly convey the organization’s understanding of all factors affecting that performance, as well as how they compare to similarly positioned peers in each market. This is an extraordinary volume of information. Organization and communication of the information is

just as important as the content itself.

IMBs must anticipate compliance changes and must put in the framework to evolve a targeted strategy for meeting the needs of LMI individuals and geographies. However, doing so is a complex undertaking that has broad effects across the organization, with broad reaching dependencies for success.

IMBs should consider how to approach it and determine if they have the resources to do so timely and successfully. These new state laws have eliminated the “if” for IMBs developing a CRA compliance framework. Now, IMBs only need to determine “how” they tackle such an important and complex endeavor.

Capco develops CRA programs with clients across the spectrum. Mitigating a punitive response from regulators is a prudent use of time and resources. We are here to help. Reach us at www.capco.com

AUTHORS

Wendy Moran, Senior Consultant
wendy.moran@capco.com

Lee Leonard, Senior Consultant
lee.leonard@capco.com

CONTRIBUTOR

Mike Peretz, Managing Principal
michael.peretz@capco.com

ABOUT CAPCO

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