Quantitative Performance Metrics for CRA:

The Challenge of Defining How Much Reinvestment is "Satisfactory"

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Preliminary Findings – January 29, 2019

Introduction

- The question of whether, and how, to quantitatively measure banks' performance under CRA is not new
  - Advocates would like to see greater accountability in CRA ratings
  - Banks would like to see greater certainty in knowing "what counts"
- The challenge has always been to develop metrics that accurately reflect the diversity of banks and community needs that exist in the United States, eloquently expressed by Comptroller Ludwig during the last round of major CRA reforms:

> "With more than 13,000 banks and thrifts in this country spread over this huge nation, with different needs and different economic times, to use simply a bright line or formulas or quotas or credit allocation doesn't work, and it creates unintended bad results. So we are not doing that."
>
> - Eugene Ludwig, Comptroller of the Currency, December 8, 1993

Introduction

- The recent Advanced Notice of Proposed Rulemaking issued by the OCC re-opens this question of metrics

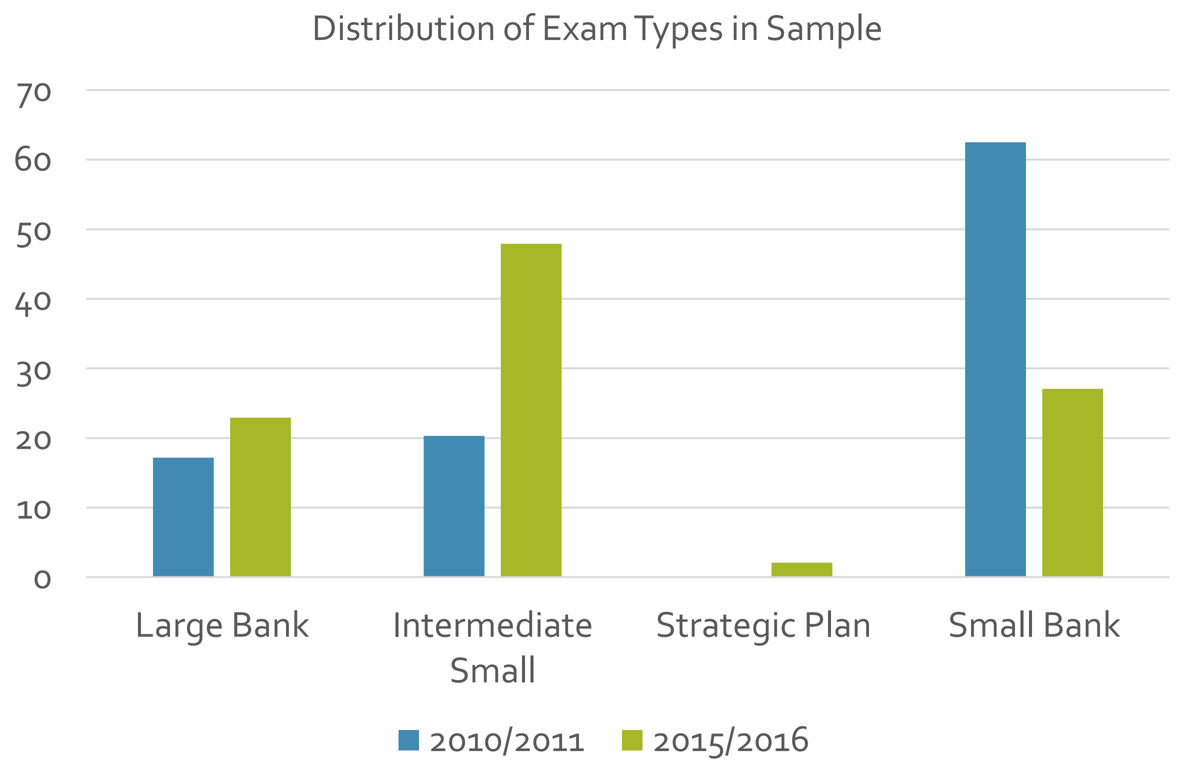
> "In a metric-based framework designed to bring clarity to the determination of CRA ratings, the benchmarks representing the dollar value of CRA-qualified activity could be compared to readily available and objective criteria… **For example, a bank with $1 billion in total assets that conducted $100 million of CRA-qualifying activities in the aggregate would achieve a 10-percent ratio, if total assets were used for the denominator."**

Introduction

- This research was motivated by the ANPR, and seeks to answer the following questions:
- What would a ratio look like if we assessed what banks have actually been doing under CRA?
- How do CRA activities—and in particular CD investments—vary by place and by economic cycle?
- To what extent could a ratio capture the “intent” of CRA, not just the “amount” of CRA activity?

Methods

- Performance Evaluations (PEs) for California for 2010/2011 ("Recession") and 2015/2016 ("Recovery")
  - 64 PEs in 2010/2011
  - 48 PEs in 2015/2016
- Manually extracted and coded every datapoint included in the PE related to loans, investments, and services (both qualitative and quantitative)
  - "Traced" CD loans and investments and interviewed recipients to assess importance of activity to meeting community needs
- Merged these data with information on bank asset size



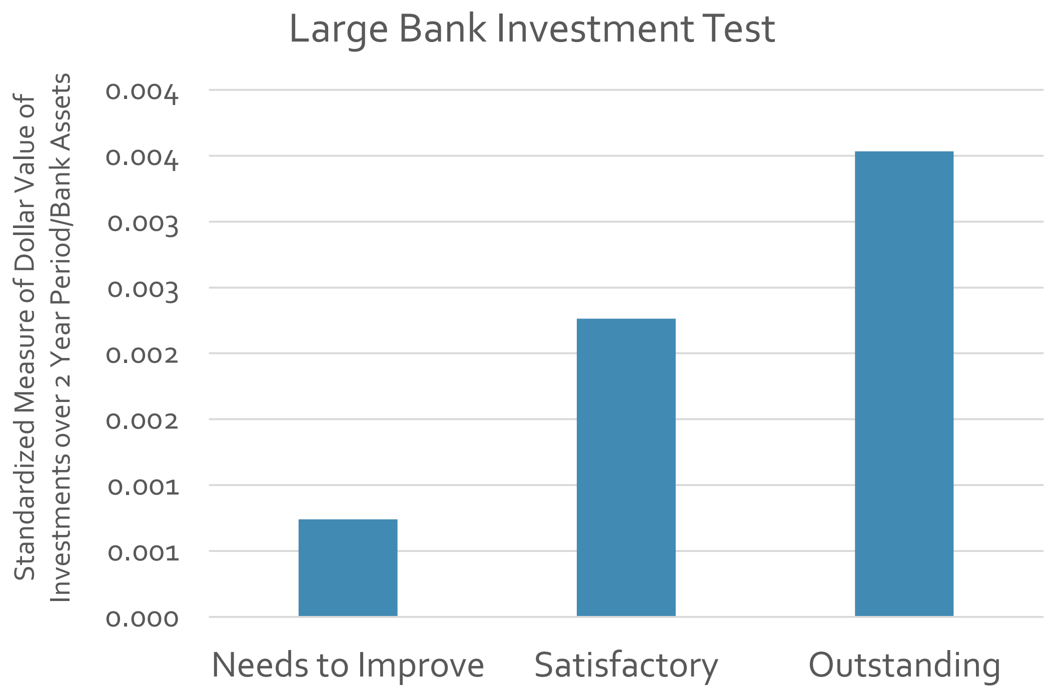
Caveats

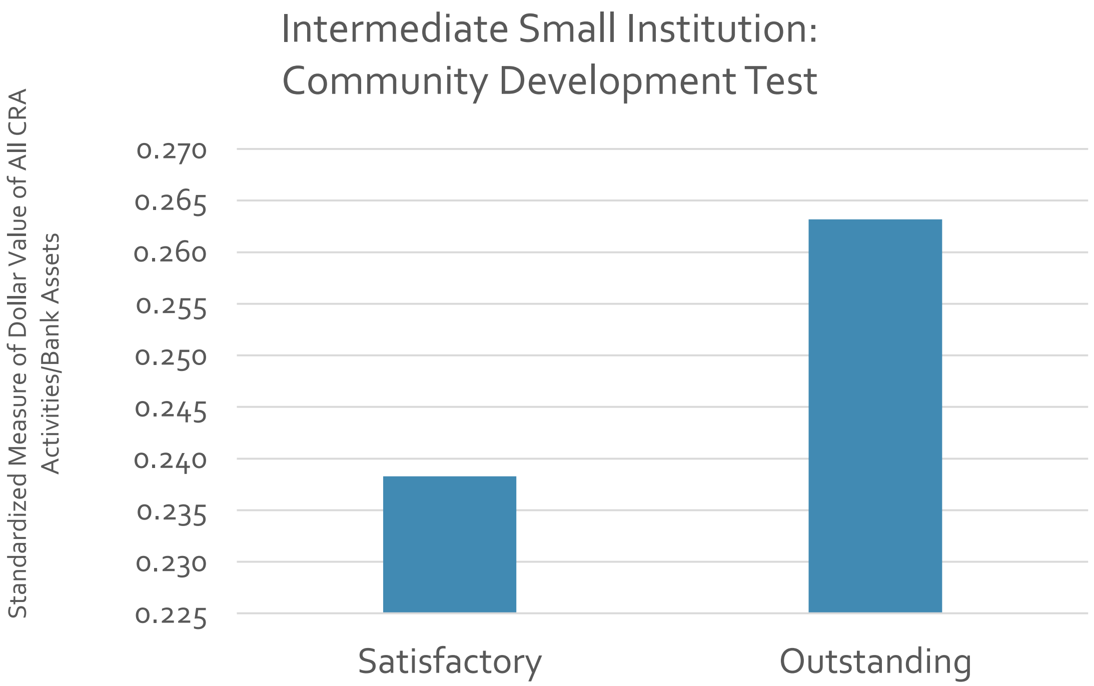
- PEs vary widely in terms of what data is collected and how those data are presented making it extremely difficult to develop consistent metrics across banks
- Coming up with a single metric requires making a lot of judgments about how to standardize the data across banks and time periods
  - Do you annualize the amount of CRA activities when different years are reported for loans than for investments?
  - How do you treat inflation? What if a PE cycle spans a recessionary and expansionary economic cycle?
  - Should banks with a national footprint be assessed by volume of activity in each state, or across all states?
    - In this analysis, we chose to calculate only activities based in California, but as a result, metrics don't reflect total volume of a bank's CRA activity
- Results here should be treated as preliminary; final working paper with more information about methodology and effects of assumptions on metrics will be completed in early April

Preliminary Findings

- Appears to be an “overall” relationship between measured CRA activity and ratings
  - This is true both for ratings on individual tests and for overall ratings
- That said, ratio of CRA activities to asset size fluctuate dramatically across banks
  - Need standardization of time periods, AA versus state versus national, approach for balancing differences in values across markets and activities
- Shifting geographies of poverty are shifting where and what kind of CRA activities are needed, but banks are not responding
- CD loans and investments: key contribution to “intent” of CRA but poorly measured

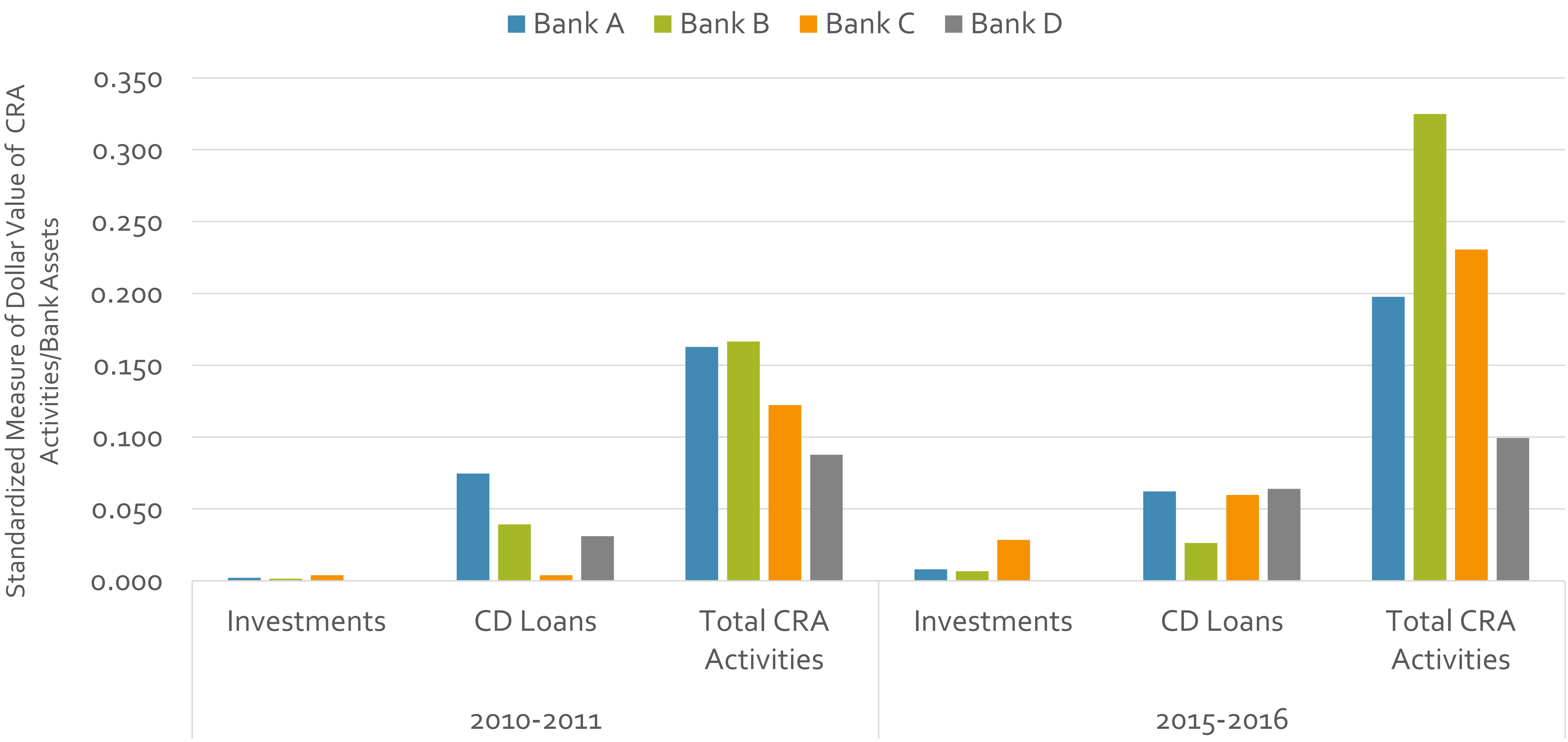
Appears to be an "overall" relationship between measured CRA activity and ratings



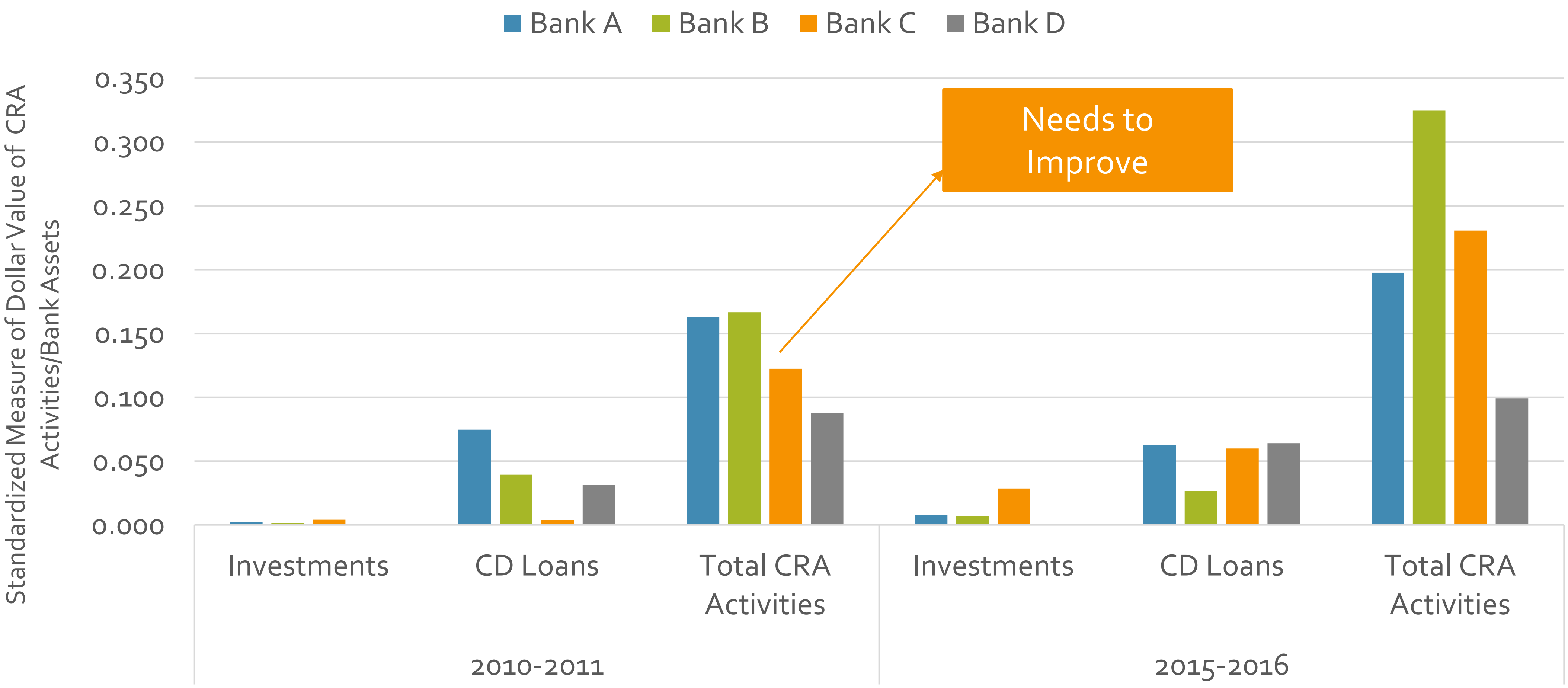


However, note that the actual difference in the metrics are small: we find a lot of clustering in total volume of CRA activities for investments and in the CD test, less so when we consider mortgages and small business loans

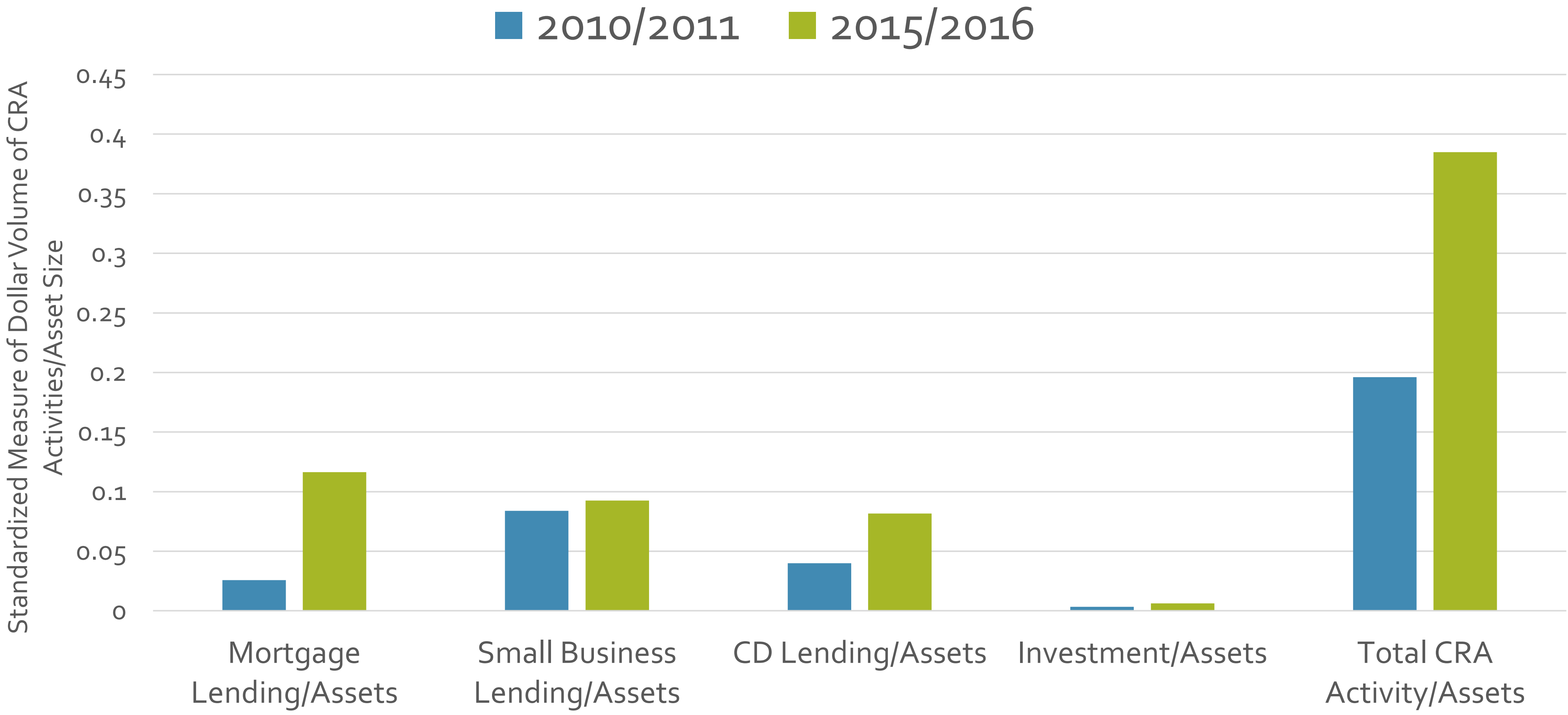
However, these averages hide variation at the local level. Consider the case of 4 Intermediate Small Institutions, all working in same assessment areas



Bank C responds to the “Needs to Improve” rating in 2010/11, moving up to “Satisfactory” in 2015/16. But at the same time, Bank B similarly doubles activity with no change in rating (Satisfactory in both time periods). Bank D gets a Satisfactory in both time periods, despite doing significantly less.



Ratios Need to Take into Account Market Cycles, But Market Cycles Affect Volume of CRA Activities Differently



Metrics Need to Account for Activity and Market Variation Across Banks

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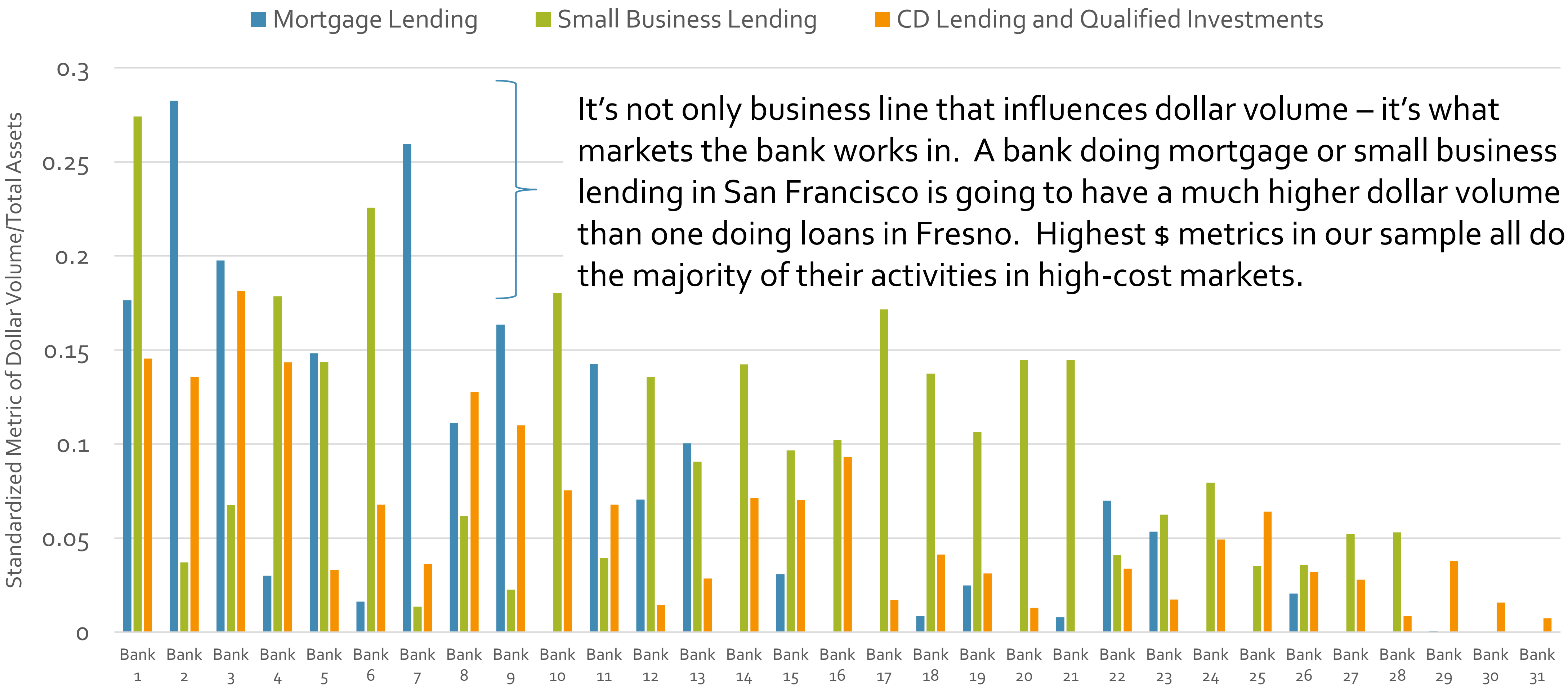
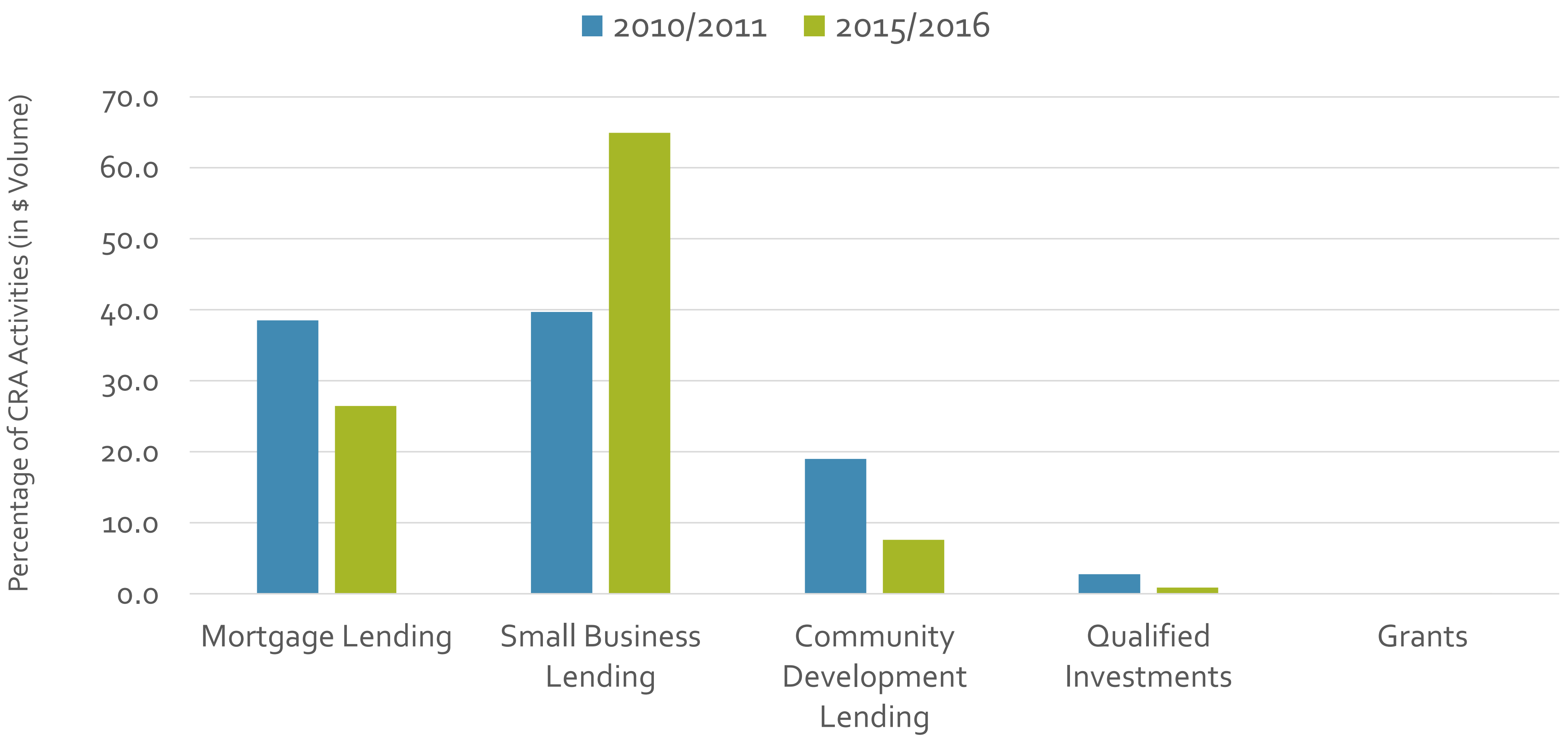


It's not only business line that influences dollar volume – it's what markets the bank works in. A bank doing mortgage or small business lending in San Francisco is going to have a much higher dollar volume than one doing loans in Fresno. Highest $ metrics in our sample all do the majority of their activities in high-cost markets.

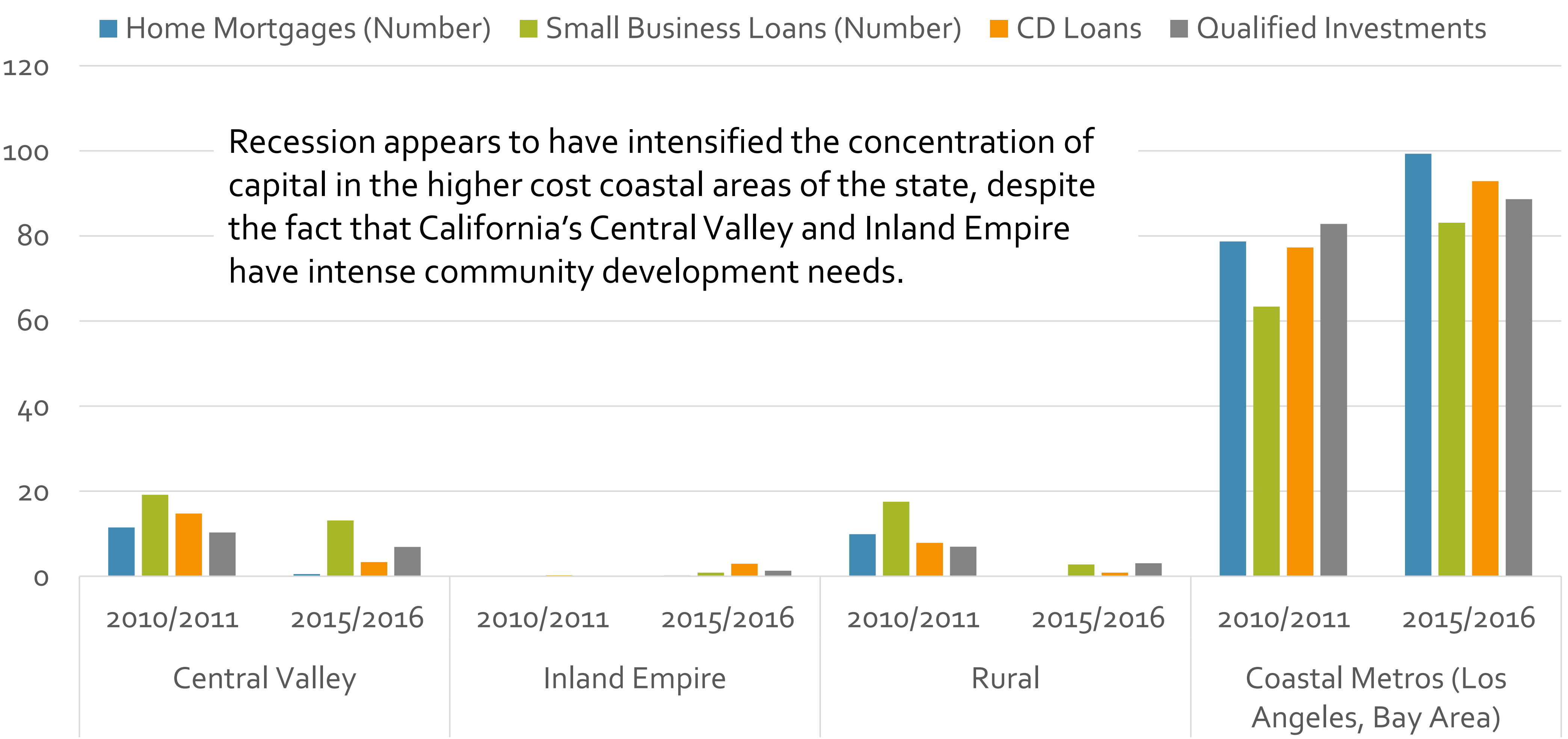
In Terms of Total Dollar Volume of CRA Activities, Mortgage and Small Business Lending Comprise Largest Share



But, CD Loans and Investments May Have Greater Impact for CRA “Intent”

- Majority of mortgage loans in LMI tracts in California are going to middle and upper income households, and to NH White and Asian households
  - In the majority of assessment areas in California, between 75 and 95% of loans made in LMI tracts are to higher-income households
- In contrast, the majority of CD loans and investments are helping to:
  - Preserve affordability of housing in rapidly gentrifying tracts
  - Making complicated redevelopment deals happen
  - Key themes from interviews: the total amount of capital matters, but interest rate/equity pricing, patient capital, willingness to manage complex deals matter too
    - Community needs is different from what is currently tracked in performance context: it’s not necessarily about percent rent burden, but rather that there’s a need for tax credit equity, predevelopment capital, a shared equity mortgage product

CRA Activities Don't Align with Shifts in the Geography of Poverty



Conclusions

- We're a long way from being able to develop effective, consistent metrics for CRA performance evaluation
- Systematically improving what is reported would move us closer to understanding what CRA activity volumes are now, and who they're benefiting
  - Improve accuracy and consistency of when, where, and what is being measured
- One concrete suggestion: focus on improved report for banks' CD lending and investment activities
  - What census tract is the investment and/or CD loan in?
  - What was the pricing on LIHTC investment deals?
  - What were the terms on CD loans?
  - What loans/investments made the "deal" happen – large $$ volume isn't always the most important measure of impact
- Under a metric based system, don't reward banks for "regular course of business" activities
  - Recalibrate mortgage lending test to assess lending to LMI households, rather than lending in LMI tracts that are experiencing rapid price appreciation