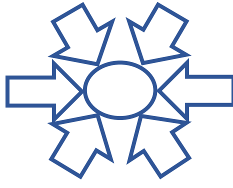

GSE Activity Report

Monday, May 16, 2022

Minimizing Mortgages, Maximizing Community Service

Summary

As we noted last week, the federal banking agencies sighed a mighty sigh and heaved up a massive inter-agency proposal rewriting decades-old standards detailing which activities earn the Community Reinvestment Act (CRA) points essential for any bank's strategic objectives and national reputation. As discussed below, the new proposal is lengthy, complex, and in some cases analytically daunting or flat-out confusing. Still one critical conclusion is clear: CRA evaluations would switch from the almost monomaniacal focus on mortgages that characterize the rule to a far wider lens encompassing many more community-development, deposit-taking, consumer finance, and small-business activities. Even where single-and multi-family mortgages count for something, the mortgages and MBS would be far more tightly circumscribed to those that meaningfully affect LMI housing, ending the blanket blessing CRA has long afforded all things GSE or FHA. This will force significant refinement in bank residential-finance strategy along with a sharp uptick in interest in innovative credit-risk mitigation and transfer options.

Impact

We will shortly complete our in-depth analysis of the new CRA construct. In short, it's a thorough rewrite of 1995 standards that cuts a middle course between the OCC's controversial 2020 rule and the Fed's largely-noncommittal advance notice of proposed rulemaking exploring an array of ways to address issues such as the transformed role of digital banking-service delivery.

The overall context of the new proposal is a considerably tougher grading system that will make each bank and especially each big bank work harder to get the high-satisfactory or outstanding CRA rating essential for branch expansion and M&A approval. These tough grades could have counteracted the new emphasis on non-mortgage finance to keep CRA-related mortgage demand as is, but regulators were on to that. The new approach thus also has various weightings designed to limit the extent to which buying a big pile of agency MBS or originating large amounts of GSE/FHA loans buys the bank a CRA start. Mortgages still matter and even still matter a lot, but the types of mortgages that benefit CRA performance is structurally different and thus strategically significant.

The rule's complexities include different definitions for which types of mortgages count for what under the community-development/service test and the retail-lending test, with MBS holdings also differently defined when it comes to those that count as community-related and those of use to wholesale and limited-purpose banks. Thus, to parse particular implications for particular products at particular banks takes in-depth analytics, but the over-arching framework in which these considerations apply has the following top-priority provisions:

Federal Financial Analytics, Inc.
2101 L Street, N.W., Suite 300, Washington, D.C. 20037
Phone (202) 589-0880
E-mail : info@fedfin.com www.fedfin.com

© 2022 Federal Financial Analytics. All Rights Reserved.

- It adopts a pro-rated approach to obtaining credit for affordable housing. Eligible loans, MBS investments, and community-service projects must have a primary purpose focused on affordable housing and CRA credit is earned for participation or holdings only to the extent the position tracks actual affordable-housing delivery or expected delivery. Comment is sought on whether partial credit should be allowed to reflect blended projects with features germane not only to affordable housing, but also to environmental resilience or other allowable objectives.
- The definition of affordable housing is tightened, allowing credit for government programs only if they have a primary, stated affordable rental housing mission, with comment sought on whether the test should be made more stringent by requiring not only that housing is aimed at lower-income residents, but is also actually occupied by them.
- Numerous activities related to obtaining, rehabilitating, or acquiring home ownership (e.g., down payment assistance) would earn CRA credit.
- Eligible MBS would need to contain a majority of affordable LMI mortgages or LMI multifamily obligations. However, comment is sought on whether partial credit could be afforded the portion of an MBS that is eligible to reflect the blended nature of many MBS, a change that would favor many more GSE and Ginnie MBS than would otherwise be the case under the proposed approach.
- Comment is also solicited on how to prevent loan and MBS churning – i.e., the practice of banks buying eligible obligations when they are about to be examined for CRA compliance and then selling them to another bank for the same purpose when its CRA time comes.
- The largest banks would now come under a retail-lending test with separate standards for residential and multi-family mortgages and open-end products, making it harder for banks to score well by balancing different products in different markets. Comment is also sought on whether open-end loans should be segmented into purchase and refis, a move that could prove problematic given the racial differences evident in refi originations. Shortages in home-purchase loans during high-refi markets would also be made clearer.

In addition, the agencies now propose to require additional racial and ethnic data filings for CRA purposes even though these are available to them via HMDA. The purpose here appears to be requiring the banks to parse the demographic data by various assessment areas, a task that would surely be onerous if not impossible for the agencies even though the proposal also gives regulators a chance to downgrade banks on fair-lending grounds on an institutional basis evident in overall HMDA data. The NPR further complicates analysis on this most-sensitive point by stating that the new data it demands would not "directly" affect a CRA rating or broader fair-lending analysis unless they showed evidence of discrimination.

Outlook

Industry comment when the rule was released was more than cautious, with trades thanking the agencies for offering up the inter-agency proposal without taking a stand on any of its content. The more they read, the more the banks became concerned not only because of the sharp increase in the likelihood of a far lower CRA rating under the new scheme, but also because the scope of changes, data demands, calculation methodologies, and reach of the rule to nonbank affiliates raises a host of substantive, operational, and cost concerns. The industry wanted and got assessment-area modernization reflecting modern banking, but it got this and inter-agency consistency at a price we suspect many will find far higher than they are willing to accept.

Comment on the proposal is due by August 5, a ninety-day period designed to quell complaints about commenting on this behemoth without letting the comment period run so long after *Federal Register* publication that a final rule comes after Republicans take control of Congress as the odds now suggest they may.

Federal Financial Analytics, Inc.
2101 L Street, N.W., Suite 300, Washington, D.C. 20037
Phone (202) 589-0880
E-mail : info@fedfin.com www.fedfin.com

© 2021 Federal Financial Analytics. All Rights Reserved.