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TKG Perspective

Teaching & Speaking Engagements

Pennsylvania Bankers Association
Advanced School of Banking
The Penn Stater Conference Center
State College, PA **July 24**
How Do Banks Generate/Measure Revenue and Performance

Maryland Bankers Association
Maryland Banking School
University of Maryland Inn & Conference Center
College Park, MD **August 1**
Bank Financial Principles

ABA
Marketing Conference
Omni Nashville Hotel
Nashville, TN **September 26**
Talking Profitability with the C-Suite

PICPA
Financial Institutions Conference
Penn State Great Valley Conference Center
Malvern, PA **September 26**
Banking Industry Update

Conferences, Conventions & Other Events

Hardshell Shootout
Conrad's Ruth Villa
Middle River, MD **July 14**

Kansas Bankers Association
CEO Forum/Annual Meeting
The Broadmoor
Colorado Springs, CO **August 4-6**

Pennsylvania Association of Community Bankers
Annual Convention
Disney's Grand Floridian Resort
Lake Buena Vista, FL **Sept 22-24**

Maine Bankers Association
Annual Convention
Omni Mount Washington
Bretton Woods, NH **Sept 22-25**

Time to Pull the Plug on CRA?

By: Jeffrey P. Marsico, Executive Vice President

In Richard J. Parson's book, ***Broke: America's Banking System,*** he suggested that bankers and examiners **major in the majors**. By that, he meant sweat the big stuff; and by big stuff, he meant risks that tend to lead to bank failures.

Lead among them, and without a near rival, is credit risk. Bankers and examiners do spend a fair amount of time mitigating a bank's credit risk, and systemic credit risk. But a close second in time and resources is the focus on complying with the myriad of laws and regulations on the books that have little to nothing to do with what causes banks to fail.

Most recently among them is CECL. Arguably, CECL has to do with credit risk and how banks account for their provision and build their loan loss reserve. But, it is an accounting standard designed to increase transparency, not mitigate credit risk. One can argue that it will do little to mitigate credit risk or increase transparency, but our trade associations already lost that battle.

So we move on and start dedicating resources, financial and human, to comply. Like bankers do with so many other rules, regulations, standards, exam practices, and laws that have infiltrated the banking system. Some laws were designed so bankers can be clandestine FBI agents, trolling their customers' transactions for nefarious activity. Think BSA.

Other laws regard social engineering, ensuring bankers are "fair", as defined by politicians and bureaucrats. This includes transparency in the form of disclosures, which few read, and add to the complexity of doing something simple like getting a long-term loan collateralized by your house. All of the paperwork customers must produce and sign is the result of, you guessed it, bureaucrats.

On the topic of social engineering, let me paint the bullseye on one that I think, by objective standards, did not work yet continues to cause much angst amongst bankers and regulators alike, the Community Reinvestment Act (CRA).

The Community Reinvestment Act

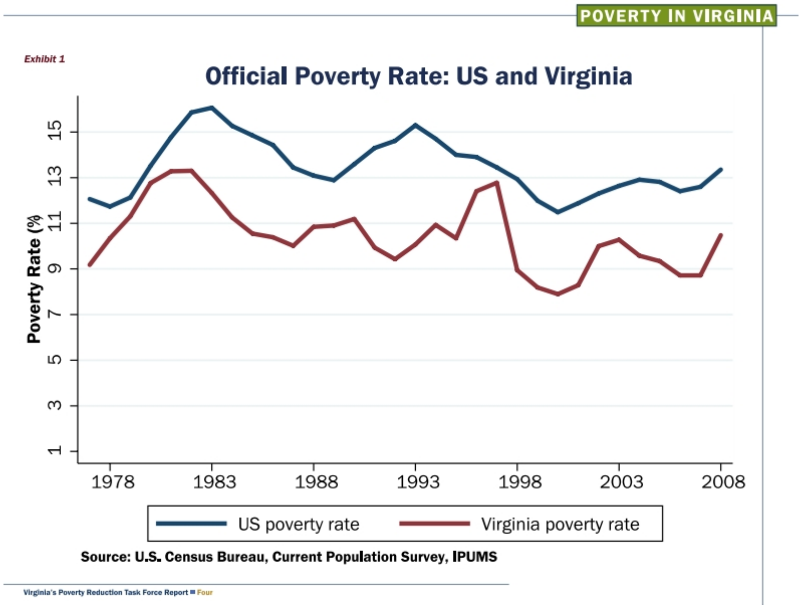
The Community Reinvestment Act was enacted by Congress in 1977 and was intended to encourage depository institutions to help meet the credit needs of the communities in which they operate, including low and moderate income neighborhoods, consistent with safe and sound banking operations.

In other words, it encouraged, even compelled, banks to lend to low income individuals under the presumed assumption that if only a low income person could borrow money they would elevate their economic status. What could go wrong?

CRA requires that each insured depository institution's record in helping meet the credit needs of its entire community be evaluated periodically in the form of a CRA exam. That record is taken into account in considering an institution's application for deposit facilities, including mergers and acquisitions.

Do you know how difficult it is to find data when conducting a search on "has the Community Reinvestment Act worked"?

I decided to see what has happened to the poverty rate in a particular state and selected Virginia. I chose Virginia because they created a 2010 Poverty Reduction Task Force in their state which had some good data, and, quite frankly, it is a state where we have a consulting presence. The accompanying chart shows poverty rates in Virginia and the United States since the CRA law was passed until 2009. You may note that there has not been any material change in the poverty rate since that time. By this standard, CRA hasn't worked.



To satisfy my curiosity about how banks fared on their CRA exams, I visited the FFIEC.gov website to check all the ratings given to banks in 1990, and in 2015. I selected 1990 because this was the earliest year the site tracked the results of CRA exams.

In 1990, 14% of Virginia banks received a “Needs to Improve” in their CRA exams and none failed. In 2015, 100% of all Virginia banks received a “Satisfactory” or “Outstanding” grade. Yet when I look at the Virginia poverty rate, the change is negligible to the naked eye since 1990.

Isn’t it time we pulled the plug on CRA? Give it a “Needs to Die” rating, so to speak. In fact, I would propose that any law designed to improve the plight of our citizenry should have a litmus test. If the results don’t pass the litmus test within a given time frame, the law dies. But that’s a larger argument for another day and another forum besides our *TKG Perspective* newsletter.

Think about how much time and resources are spent on CRA. Wouldn’t our examiners time be better spent on things that are most likely to cause banks to fail, such as credit risk? Our system would be safer and more sound, in my opinion.

Banks in general, and community banks in particular, should have their own social improvement programs. Why? Believe me, I’m a firm believer that a shareholder owned institution’s primary responsibility is to its shareholders, but banks are intricately tied to the plight of the communities in which they operate. If the local military base or large manufacturer picks up stakes and leaves, the local community bank better be part of the action plan to replace that economic activity. Or they risk seeing their customers suffer economically, and their loan portfolios bleed under the weight of unemployment and despair.

Three Ideas to Replace CRA

If CRA were to be pulled, here are more productive things I think community financial institutions could do with their newfound available resources.

1. **Build a scholarship fund for skills transition**. Technology has accelerated economic change and the skills needed to succeed in our new world. We don’t need riveters that affix car doors, and the union prevents them from moving to help out the dashboard guy. Instead, we need workers that can operate and repair robotic arms. This is only one example of the skills transition needed in today’s rapidly changing economy. Banks can be a part of helping residents make those transitions.

2. **Train employees to be concierges** to help local residents access private and public assistance to improve their lives. There are myriads of programs, scholarships, and resources available to help low and moderate income people elevate their economic status. But it’s complicated and it requires mentorship, guidance, and experience. Instead of the haphazard way that community financial institution employees volunteer, and receive paid time off to volunteer, channel their efforts for a finite set of objectives to help people and their communities rise up.

3. **Sponsor a local Shark Tank**. Shark Tank is one of my TV indulgences. It puts entrepreneurs in front of a panel of private investors to pitch their business and get funding. Genius! Why don’t we do this? Lack of capital is a primary reason for business failure, or its inability to achieve scale. Why can’t a bank have an equity fund that they contribute to, along with local private investors? A panel of investors could evaluate local businesses and award capital to the most promising ones. As CRA stands now, lawmakers and examiners would have us lend to these businesses. But a loan to an early stage business is like an equity investment with no upside, and servicing debt puts pressure on the business’s cash flow. It doesn’t make sense for a business you want to thrive and grow.

These are just a few ideas that community financial institutions could employ to improve the economic status of their communities, and in so doing improve prospects for the bank to thrive.

Or, we could continue to log our community hours on a spreadsheet as part of the documentation needed for a good CRA rating.

TKG, as part of our consulting and advisory engagements, frequently evaluates our industry, its trends, successes, and challenges. We are pleased to share our thoughts with you, our valued clients and friends, in the form of this periodic newsletter. If you would like to discuss anything further, or learn more about our performance measurement, strategic planning, regulatory assistance, process improvement or financial advisory services, please call us at (973) 299-0300 or visit us at www.kafafiangroup.com.

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