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Using Purchased Loans to Meet Fair Lending and CRA Goals

By Stephen E. Sudhoff, CFA, President, Jefferson Cook Associates, Ltd.

In several recent fair lending enforcement actions, fair lending violations have been based upon statistical analyses of the number of loans made or loan applications taken in subcategories of majority-minority census tracts. CRA standards, in contrast, focus upon the dollar value of investments (including loans) made in low- and moderate-income (LMI) census tracts (among other things). Taken together, and considering the high degree of overlap between majority-minority census tracts and LMI census tracts, these enforcement actions and standards suggest a model for using purchased loans to meet CRA goals as well as fair lending origination goals.

We've prepared a simple example of an institution which plans to make loans in five census tracts. Goals (and performance) can and should be set at a macro level, but should ideally also be set at the census tract level, as regulators analyze loans at this same level of geographic granularity. In this example some census tracts are LMI, some are majority-minority, some are neither, and some are both. We'll also consider just two stages in the lending process; applications and originations. The data is presented in the table below.

A Census Tract	B LMI tract	C Majority-Minority Tract	D		E		F		G		H		I		J		K		L		M		N	
			Fair Lending: # of Applications		Fair Lending: # of Originations		CRA: \$ Amount Originated		Over (Under) CRA Goal		Purchased Loans		Loans Funded											
			Goal	Actual	Goal	Actual	Goal	Actual	Goal	Actual	#	\$'s	#	\$'s										
1111	Y	Y	10	5	6	4	\$ 1,000,000	\$ 700,000	\$ (300,000)	2	\$ 200,000	6	\$ 900,000											
1112	Y	N	10	10	6	8	\$ 1,000,000	\$ 800,000	\$ (200,000)	-	\$ -	8	\$ 800,000											
1113	N	N	10	15	6	5	\$ -	\$ -	\$ -	-	\$ -	5	\$ -											
1114	N	Y	10	7	6	6	\$ -	\$ -	\$ -	-	\$ -	6	\$ -											
1115	Y	Y	<u>10</u>	<u>10</u>	<u>6</u>	<u>6</u>	<u>\$ 1,000,000</u>	<u>\$ 1,100,000</u>	<u>\$ 100,000</u>	<u>2</u>	<u>\$ 200,000</u>	<u>8</u>	<u>\$ 1,300,000</u>											
TOTALS:			50	47	30	29	\$ 3,000,000	\$ 2,600,000	\$ (400,000)	4	\$ 400,000	33	\$ 3,000,000											
Majority-Minority Tracts			30	22	18	16				4		20												



The analysis starts by assuming a simple fair lending goal, of equal numbers of applications (column D) and originations (column F) in each census tract. An institution's own fair lending analysis, of course, will need to be much more detailed, by taking into account not just minority status (which is a combination of racial and ethnic characteristics), but by considering lending activities to each individual race and to Hispanics by themselves, as well as considering other protected class characteristics (age, gender, etc.). An institution's own analysis should also ideally consider concentrations of protected class households greater than majority (50%), e.g., high-minority (80%).

For CRA goals and performance, focus on the tracts which are indicated as LMI (per column B). The CRA goal is for \$3 million total investment (column H), but the institution's own originations only garner \$2.6 million (column I), leaving a shortfall of \$0.4 million (column J).

For fair lending goals and performance, focus on the tracts which are indicated as majority-minority (per column C). The goal was for 30 applications in these tracts (column D), but only 22 were taken (column E). The goal was for, likewise, 18 originations in these tracts (column F), but only 16 occurred (column G), leaving a shortfall of two originations.

To meet both the CRA and fair lending goals, the institution can purchase two loans for a total of \$400,000 in both census tract 1111 and 1115, which are both LMI and majority-minority tracts (columns K and L). These additional four loans, combined with the 16 originated, will put the institution above its origination goal of 18 for majority-minority tracts, while enabling the institution to meet its CRA goal of \$3 million invested (columns M and N).

Purchasing loans in census tract 1112 will help the institution meet CRA goals, but do nothing to help the institution meet fair lending goals. Purchasing loans in tract 1113 will not help the institution meet either CRA or fair lending goals. Purchasing loans in tract 1114 will help the institution meet fair lending goals, but not CRA goals.

One final note: we've assumed that originations are made proportionately to the minority composition of each census tract (so for a tract which is 50 percent minority, half of the applications and originations would come from minorities). If originations are not proportional, then purchased loan activity may need to be adjusted in order to achieve a desired benchmark of minority participation.

Conclusions:

Purchased loans can indeed help an institution simultaneously meet CRA goals and fair lending origination goals, provided that there is overlap between LMI census tracts and census tracts with concentrations of protected class households (in this example, majority-minority households).

Purchased loans should not be assumed to help the institution meet fair lending application goals; the regulatory guidance is at best fuzzy on this point, and in the Hudson City case the CFPB ignored considerable purchased loan activity in majority-minority tracts.

Key Takeaways:

Purchased loans can help an institution simultaneously meet CRA and fair lending origination goals.



If there is a high degree of overlap between LMI and majority-minority census tracts, then it will be difficult to meet CRA LMI-based goals without meeting fair lending goals.

