

2009

# All American Bank

## CRA Process Review

An evaluation of the systems and procedures used by AAB to collect, compile, monitor, evaluate, manage and report its CRA performance

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# All American Bank CRA Process Review Report

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Compliance responsibility for any bank begins with reliable data. No bank can execute its CRA responsibilities without complete, accurate and timely data. *Data integrity* is therefore the highest priority. All American Bank (AAB) in recognition of the absolute necessity of reliable data for an effective compliance function has commissioned an independent review conducted by GeoDataVision of the “Process” employed by the Bank to maintain its CRA program and responsibilities. The goal of the Review is to identify systemic and specific weaknesses and make recommendations for the correction or improvement thereof.

The “CRA Process” refers to the CRA Policy and the systems and procedures developed to *manage* CRA-related compliance risk and to collect, compile, clean, evaluate, and report CRA-related data. The “Process” includes, among other things:

- Board-approved CRA policy
- Record keeping
- Quality control
- Oversight

This Report summarizes the findings and recommendations of GeoDataVision with respect to these facets of the CRA Process at AAB. In addition, because the results of its most recent CRA performance evaluation contained criticism of the Bank with respect to its Community Development responsibilities AAB has requested that GDV supplement this Review with an examination of Community Development loans, investments and services identified by the Bank and the procedures related to Community Development as it is applied under CRA.

## Executive Synopsis

A review of the extensive documentation provided to GeoDataVision for this Report clearly demonstrates a strong commitment on the part of the Bank to develop and maintain a highly professional CRA compliance program. The Bank has developed detailed written procedures and policy pertaining to most HMDA and CRA-related functions. These procedures are supplemented by an extensive number of forms for data entry and data entry review as well as for Community Development loans, services and investments.

At the same time, there is an absence of certain key items in the Bank’s CRA *policy* that should be corrected and added and there are steps within *procedures*

and several items within the data entry *forms* that should be changed or added that will make data integrity more reliable. For example, the Bank's CRA policy omits any reference to Community Development lending. Also, while there were well documented procedures for CRA and HMDA data entry and review, there were no clear procedures for resolving differences discovered during the review process. Once a potential error has been identified, how is a difference of opinion resolved and how is a discovered error corrected and by whom? These are situations that are not *documented* in the CRA and HMDA procedures (although there may be an informal unwritten procedure to do so). Also, while the Bank has personnel who are familiar with CRA, there does seem to be some gaps in understanding the technical definitions of some CRA terminology. For example, the Bank has claimed as a qualified "community development service", the civic activity of certain directors, officers and employees without adequate documentation regarding the capacity in which the person acted, nor the financial aspects of the service rendered. But to qualify for community development credit under CRA, the activity must be financial in nature (e.g., chairing the finance committee of a qualified organization) and it must be done in the capacity of a representative of the Bank, not as an individual. There are instances in which the Bank appears to be claiming credit for "community development services" the civic work volunteered by its directors, officers or employees that does not appear to have the requisite financial nature or was rendered in the capacity of an individual rather than Bank representative.

The following points summarize the findings and recommendations of this Report as explained in more detail in the body of this Report.

#### Findings:

- Policy - the Bank maintains extensive written procedures and policies but some gaps exist that need to be filled. (a) The Policy does not mention the CRA Committee standing members (i.e., Bank President, Senior Loan Officer, CRA Officer, etc.) or (b) community development loans. (c) Policy refers only to "documentation" of *community development investments* and an "assessment" of the need for *community services, but does not make a statement regarding the Bank's commitment to those community development activities.* (d) Policy does not contain a CRA Sunshine Provision
- Personnel - there is some understandable confusion among AAB personnel about highly technical but nonetheless very important CRA definitions and interpretations, particularly related to "community development" as it is defined in the Regulation and the documentation necessary to support claimed community development activities
- Procedures – (a) the Self-Assessment Report contains some excellent information but omits clear performance standards and objectives for

comparison to AAB results. Clear performance goals and standards are very critical to the management of AAB CRA performance. (b) Data entry and review instructions don't spell out how potential errors are resolved and corrected and (c) there appears to be no reconciliation between CRA small business loans and the loans recognized as small business for Call Report purposes and (d) the capture of HMDA data from the LOS appears to be manual requiring a substantial amount of time and creating an increased potential for data error.

- Forms - while the Bank has developed and maintains some comprehensive data entry forms, (a) the completion of those by personnel sometimes is inconsistent or superficial. Most of the forms are excellent in their design, but (b) at times the completed documents contain conflicting or inadequate information and in some instances incorrect instructions.

#### Recommendations:

- Policy – Policy should (a) establish the CRA Committee in a totally separate section of its own and identify the standing members of the CRA Committee (to include a Board representative), (b) add a community development lending section, (c) more fully develop community development investment and services policy to state AAB will support community needs through investment and services commensurate with the community's needs and the Bank's resources, (d) incorporate a CRA Sunshine Provision and (e) delegate sufficient "push back authority" to the CRA Officer
- Procedures - It is recommended that the Bank (a) adopt clear steps for resolution of errors discovered in the data entry and review process, (b) implement a process to reconcile the records coded as small business for the Call Report and those identified for the CRA annual filing, (c) clearly identify a written CRA audit program (the documents provided to GDV for review were not identified as internal audit procedures but appear to be copies of RSM McGladrey documents and other sources) and (d) look into the possibility of a software interface between the LOS and the HMDA LAR to save time and money and reduce the potential for data error
- Personnel - In light of the critical priority of the Bank's community development efforts it is recommended that personnel receive additional in-depth training focused on Community Development as it is applied under CRA
- Forms – (a) It is recommended that data forms for Community Development clearly spell out the activity being funded and the

application of the proceeds and how it relates to “community development”. Moreover, although the forms require the identification of which definition of community development applies in the situation at hand, there is no explanation of why the activity has been interpreted to fulfill the definition. (b) It is suggested that the CRA Self-Assessment Process include specific performance benchmark data similar to that used by examiners for comparison to AAB results

## Methodology

In order to conduct its review GeoDataVision:

- examined CRA-related documents, forms and reports used by the Bank
- reviewed policies and procedures pertaining to CRA and HMDA
- tested CRA records
- interviewed personnel responsible for the CRA function

The Bank submitted to GeoDataVision for the purposes of this Report, copies of all CRA and HMDA-related policies and procedures as well as related reports and information pertaining to compliance personnel. The following is a list of the documents examined by GeoDataVision to prepare its observations and recommendations to AAB:

1. Policies and Procedures Documents
  - a. CRA Policies
  - b. CRA data entry and data review procedures
  - c. HMDA data entry and data review procedures
2. Most Recent HMDA LAR
3. Most Recent CRA Institutional Register Summary
4. Most Recently filed CRA micro-data file
5. YTD micro-data file
6. Employees responsible for CRA / HMDA
7. Training Materials
8. HMDA and CRA internal audit program and self-assessment program
9. Audit Responses
  - a. Internal audit
  - b. Self-assessment
  - c. Exam comments
10. Copies of HMDA and CRA-related forms
11. Board Communications regarding HMDA / CRA
12. FFIEC Disclosure Statement

13. CRA Public file documents
14. CD loans, investments and services 2008 YTD
15. Community Development Activity (loans, investments including donations and services) worksheets as well as the
16. Edit check results
17. CRA Committee minutes for 2008

After reviewing these documents GeoDataVision prepared an outline of preliminary observations, questions and recommendations.

GeoDataVision then compared the CRA micro-data to the Institution Register Summary, the Call Report codes and the original credit file information. Finally, GeoDataVision interviewed personnel responsible for the CRA Process at AAB, including data entry personnel, internal auditors, the CRA Officer, commercial loan officers and Bank management.

## CRA Policy

The Bank maintains a CRA policy last revised in March of 2007. The CRA Policy addresses the following areas:

- AAB commitment to the community
- The AAB Assessment Area
- Organizational duties of the Board, CRA Officer, Chief Operating Officer, Chief Financial Officer and the Director of Retail Banking
- Plan for Assessment of Community Needs
- The CRA Committee
- Non-discrimination in credit
- Fair Lending Compliance
- Lending
- Investment
- Service
- CRA documentation including maintenance of the public file
- Public Notice
- Audit

As is evident from the above listing, the AAB CRA Policy is comprehensive, covering a wide range of CRA-related issues. However, the Policy can be improved by incorporating some additional topics, elaborating on existing topics and rewording some of the phrases used in the current policy that can be confused because of particular and unique meaning with the Community Reinvestment Act.

GeoDataVision suggests that sections should be added to the CRA Policy to include a "CRA Sunshine" section and a "Community Development Lending" section. The CRA Sunshine provision relates to "covered agreements", if any should exist, between the Bank and a non-government entity and public disclosure requirements. Sample wording would be as follows:

#### **CRA SUNSHINE PROVISIONS**

The CRA officer and committee shall annually determine whether the institution has entered into any covered agreements with nongovernmental entities or persons (NGEPS) in excess of \$10,000 (or \$50,000 for loans) during the previous calendar year.

A. Regulatory Agency Annual Disclosures

If such covered agreements exist, the CRA officer shall file the appropriate annual report with its supervisory agency.

B. Public Disclosure

The CRA Officer must make a copy of any covered agreements available upon request to any individual or entity that makes such a request. The CRA Officer may withhold any confidential or proprietary information that the bank believes the relevant supervisory agency could withhold pursuant to the freedom of information act.

The existing CRA Policy also does not contain any statements pertaining to Community Development Lending. It is suggested that a separate section pertaining to Community Development Lending be added to the CRA Policy. The section should affirm the Bank's commitment to supporting community development needs as identified during the Community Needs Assessment process and require the maintenance of documentation sufficient to support the community development qualifications of any community development loans.

In addition to the foregoing new sections to the CRA Policy, several sections should be expanded or reworded. In particular, the sections pertaining to Community Development Investments and Community Development Services should be expanded to affirm the Bank's commitment to its CRA Community Development responsibilities with respect to investments and services. The current policy merely states a commitment to "maintain adequate documentation of the Bank's investment efforts" or to conduct an "assessment" of current services. The commitment to fulfill these needs may be implied, but it should be explicitly stated.

The Public file section should clearly state that the public section "of the most recent regulatory CRA performance evaluation" will be available to the public (not the entire performance evaluation). Also, a paragraph should be added about including the CRA Disclosure Statement in the public file now that the Bank has elected to voluntarily file its CRA data.

The Board of Directors section speaks of an annual review of the “delineated community and credit services” but does not include Community Development activity, including community development loans, investments and services. These subjects should be of particular concern to the Board in light of the most recent CRA performance evaluation.

The CRA Policy alludes to the CRA Committee under the Section “Strategic Plan for Assessment of Community Needs”. In light of the importance of the CRA Committee and its critical responsibilities, it is suggested that the CRA Committee be established in a totally separate section of the Policy. The CRA Committee’s membership and responsibilities (including development of an assessment of community needs) should be delineated within this section. It also is suggested that the Board should have a representative on the CRA Committee.

Finally, the section entitled “Strategic Plan for Assessment of Community Needs” should be reworded because of potential confusion. In the context of CRA, the term, “Strategic Plan” has a specific meaning that refers to the elective a bank may choose to develop a “Strategic Plan” that contains all the measurable goals and objectives that will be used by examiners to evaluate the bank’s CRA performance in its entirety. A CRA “Strategic Plan” is an actual document that is subject to a formal public review process and Regulatory Agency approval. On the other hand, “Community Needs Assessment” is the term used within CRA to describe a bank’s effort to identify the needs of the community based on demographics, credit market information and feedback from community groups and government agencies. This would be the more appropriate term for AAB to use based on its intention to describe its efforts to identify Cape May County needs.

## CRA Procedures

The procedures related to CRA implemented by AAB were presented to GeoDataVision as contained in the documents “CRA Loan Document Review Procedures” and “Review for Community Development Loans”. These documents describe data collection, recording and review. The documents do not address any other CRA responsibilities. No document that describes the entire CRA process, from data collection to data reporting and management oversight was presented for consideration. It is recommended that such a comprehensive document be developed by AAB.

The documents that were presented more accurately describe data entry and data review procedures within AAB. These documents appear to be intended to identify, collect and accurately record “Small Business loans” and “Community

Development loans” as they are defined in the CRA. With respect to these documents:

- The “procedures” document does not include instructions about the “business/farm gross revenue” field. This field requires codes based on gross annual revenues of the borrower. This explanation should be added
- The “procedures” document does not describe the data *worksheet* preparer and the data *worksheet* reviewer to distinguish from the “LAR Preparer” and the “LAR Reviewer”. This description should be added to avoid any confusion
- Technically, CRA does not require collection of loan applications (as does HMDA). It requires collection and reporting of loan originations and loan purchases. Therefore, the correct term is the CRA *Loan Register*. *The wording should be modified to reflect the “LR”*
- The “procedures” document does not address how errors and differences of opinion regarding CRA loan codes are to be resolved. This part of the process should be added
- The “procedures” document has an incomplete bullet point at the bottom of the first page
- The “community development” document does not explain that “economic development” as it is defined under CRA requires “permanent job creation, retention or improvement” for LMI persons or in LMI areas. This explanation should be added to assist loan officers in collecting the required documentation
- The “community development” document incorrectly states, “For participations, the loan amount purchased by the bank is reported . . . .” The entire amount of the loan should be reported under present reporting rules.
- There should be a procedure that reconciles the small business loan records identified for CRA and the loan records coded as “small business” for Call Report purposes. This is recommended because it is a good practice to make certain the Bank is consistently coding loans properly and it avoids the potential embarrassment of reporting a loan inconsistently for CRA and Call Report purposes. We are not suggesting reconciling the Call Report with the CRA annual data. We are recommending comparing the data entry journals for the Call Report and the CRA micro-data file.

No formal CRA internal audit program was presented to GDV for consideration. Nor was any actual audit of CRA records submitted for review. AAB did provide a HMDA audit that was quite comprehensive and sophisticated. But, as

was the case with CRA, no HMDA audit program was presented for review by GeoDataVision. The Bank should develop a narrative that is identified as the “audit program” for both CRA and HMDA. The copies of external documents such as the McGladrey & Pullen documents are the basis for such an internal audit program, but should be retyped and clearly labeled as “CRA” or “HMDA Internal Audit Program and Procedures”.

The Bank did provide a “HMDA Review Procedures” document that was similar to the CRA document in that it describes data collection, entry and scrubbing procedures. The document is more lengthy than the CRA document. Similar to the CRA document it does not identify the persons involved with preparation and review of **data worksheets** clearly. There are numerous sections with different color font for which there is no explanation. Finally, this document refers to the “Checklist for the person completing the LAR” but no document labeled “checklist” was provided for review. *This document suggests a data recording process that requires extensive manual data entry of data that appears to be recorded in the Bank’s software already. There should be a software interface between the Bank’s LOS and the HMDA LAR. This would save the Bank many hours of personnel time and would significantly reduce the potential for data entry error. It is strongly recommended that the Bank investigate this potential streamlining of data capture and reporting.*

### **Comment on the need to establish specific CRA performance standards**

The CRA Committee is charged with performing an evaluation of AAB CRA performance. Indeed, the records indicate that the Committee meets frequently. Moreover, the Committee has identified a number of CRA performance parameters, but it has not established performance goals. This is very important to correct immediately. The failure of AAB to establish quantitative CRA performance standards makes it difficult, if not impossible, to really measure the Bank’s CRA performance. Furthermore, it puts the Bank at a disadvantage when presenting and discussing CRA performance with examiners because there will be no common ground to rate CRA performance. Examiners will not divulge the specific standards they employ to judge “satisfactory” performance. If the Bank does likewise, a communication gap will occur between examiners and the Bank and it will not be possible to bridge the gap. If the Bank develops thoughtful, reasonable and defensible performance standards it is in the position to be its own judge of its performance. It will recognize performance shortcomings, if any, and either develop a plan of action to correct those deficiencies or it will understand and be able to explain the external factors that distort the comparison and make it an inaccurate measure of the Bank’s performance. Insightful analysis supported by facts will be respected by examiners.

## Comment on the practice of adhering to the AAB CRA procedures

An examination of 15 Community Development loan records submitted for review indicates an inconsistency in the quality of the documentation supporting the community development qualification of these loans. Several loan records contained substantial documentation supporting the community development qualifications of the records. But many records did not have sufficient documentation to justify the claimed community development credit. It is critical that the Bank not only have a process and forms in place to support community development activities, but that procedures and documentation be followed in a scrupulous manner in order to assure sufficient documentation to withstand examiner scrutiny. Discussion with the CRA Officer indicated some concerns with respect to adherence to the Bank's internal guidelines. *The CRA Officer should be given enough "push back" authority to make certain that all responsible personnel comply with internal CRA procedures.*

## CRA and HMDA Forms

AAB has submitted to GeoDataVision a significant number of CRA and HMDA forms for review and comment. We already have commented on a number of the forms under the "CRA Procedures" section. In particular, GDV commented on the data entry and review forms used for CRA and HMDA data recording. The following forms were reviewed and our comments are as follows:

- "Contribution Guidelines" and the "Donation Request Application" forms: these are excellent documents that possess some of the most critical elements in the determination of the Community Development qualifications of an organization or an activity to which the Bank may contribute. We suggest that the Application be modified to change the question, "If requested, what documentation can you provide to support the primary purpose of this donation", to require the precise documentation needed to determine the CD qualifications of the organization/activity. Not only is far easier to get that information before the request is granted, it is far less embarrassing to decline a request initially rather than approve it and then have to inform the recipient that you will not fund the grant because of a lack of required documentation
- "Review for Community Development Loans" form: Very good design and information content. We suggest that it explain that "economic development" means "permanent job creation, improvement or retention for LMI persons or in LMI areas" and that

revitalization/stabilization” means “attracting or retaining people or businesses to LMI geographies or areas targeted by federal, state, local or tribal government”. We also suggest that it be required to explain why the specific CD definition applies to the requested loan. (Of the CD forms we observed during our review many omitted an explanation of how the activity fulfilled the CD definition claimed in the document and assumed the reader would understand the underlying rationale supporting the community development definition cited by the writer. But the underlying reasons were not evident to GDV when reviewing many of these records). [THESE COMMENTS APPLY TO THE CD INVESTMENT AND SERVICES FORMS AS WELL]

IT IS VERY IMPORTANT FOR THE BANK TO UNDERSTAND THE CRITICAL DISTINCTION BETWEEN “COMMUNITY SERVICES” RENDERED BY THE BANK’S REPRESENTATIVES AND THOSE DELIVERED BY COMMUNITY ORGANIZATIONS. ANY ACTIVITY CLAIMED BY THE BANK FOR THE ACTIVITIES OF ITS REPRESENTATIVES MUST CONTAIN A FINANCIAL COMPONENT SUCH AS CREDIT WORKSHOPS OR SERVICE ON THE FINANCE COMMITTEE OF A QUALIFIED COMMUNITY ORGANIZATION AND MUST BE DONE IN THE CAPACITY OF A BANK REPRESENTATIVE, NOT AS AN INDIVIDUAL CITIZEN

## Board Communications

Board minutes presented for the period beginning February 25, 2008 through October 27, 2008 reveal comments on the Bank’s CRA performance in 14 different Board meetings. These meetings demonstrate a high level of commitment to remedial action. However, without clearly established performance goals the question of “satisfactory” CRA performance is left somewhat open-ended. It is strongly recommended that the Board recognize the CRA performance tests and determine appropriate and defensible performance standards for each test. Every month, until the Bank earns a “satisfactory” performance rating, the Board should be presented with a CRA Performance Report that juxtaposes AAB performance with the performance standards.

## CRA Public File documents

A review of the public file contents as presented on a CD to GeoDataVision shows that all required documents except an Assessment Area map are maintained in the public file. An Assessment Area map must be added to the public file.

It is suggested that the CRA Officer sign and date a document stating that no public comments have been received for the Period \_\_\_\_ if no such comments have been received during the year (in the absence of such a statement an examiner does not know if such comments have been received but not included in the file or if no such comments were received). Also, it is suggested that the CRA Officer certify to the Board as of April 1, each year that the public file is up-to-date, accurate, and complete and a copy of the certification be placed in the public file. This is not required by the Regulations but is a good practice.

## Personnel Training

The records submitted to GeoDataVision show the Bank has committed to extensive training of CRA personnel. The records show that during 2008 the following training-related seminars and conferences were attended by AAB personnel:

- "National Interagency CRA Conference" sponsored by SF FRB and Federal Bank Agencies
- CRA Public file responsibilities – demonstrates many employees received training, but need to show agenda and trainer
- "Preparing for your Next CRA Exam" by CRA Qualified Investment Fund
- "HMDA – Frequently Asked Questions" presented by BOL
- XYZ Compliance Consultants will conduct training in December regarding CRA and HMDA

This extensive training notwithstanding, AAB personnel still need to learn more about the complicated and confusing technical aspects of the Community Reinvestment Act in order to assure an understanding of the Bank's performance responsibilities and how to measure and manage them.