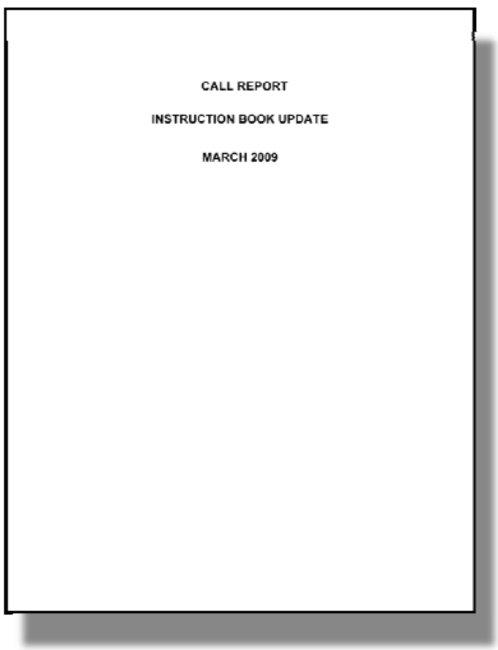
New Call Report Instructions with Big CRA Implications

New Call Report instructions issued by the FFIEC appear to have significant implications for loans categorized as “small business” for CRA purposes. This is because what is defined as a recognizable small business loan for CRA purposes is based on the Call Report definitions. Until now, any loan secured by residential real estate, except in “abundance of caution” circumstances, would be classified as loans secured by real estate for Call Report purposes.

This would disqualify many loans made to small businesses partially collateralized by a lien on the residence of the principals. The new instructions define “loans secured by real estate” in a very different manner than heretofore. Until now, loans secured by real estate were defined as follows:


CALL REPORT

INSTRUCTION BOOK UPDATE

MARCH 2009

> For purposes of these reports, a loan secured by real estate is a loan secured wholly or substantially by a lien or liens on real property for which the lien or liens are central to the extension of the credit – that is, the borrower would not have been extended credit in the same amount or on terms as favorable without the lien or liens on real property

This old definition left a considerable amount of ambiguity because it was left to the judgment of the reporter as to whether they would have extended the credit on the same terms as without the real estate collateral. In all but the most extreme situations bankers would report almost any loan with real estate partially securing the loan as a “loan secured by real estate”. The new definition (found on page A-58 of the glossary) retains the same phrasing but adds a specific formula to determine if a loan qualifies as a “loan secured by real estate” and specifies that when it does not qualify as such it should be reported “according to its purpose”.

The new formula basically is that the residual collateral value of the real estate must be more than 50% of the value of the loan at origination. This means a loan for a business purpose would be reported as a "commercial and industrial loan", even if it were partially secured by residential real estate (as long as the real estate collateral value was 50% or less of the loan value at origination) thereby making any loans for $1 million or less (the current loan limit qualification) reportable small business loans. <u>When a loan is not qualified as a real estate secured loan the governing rule is the primary purpose of the loan</u>:

> . . . when a loan is partially secured by a lien or liens on real property, but the estimated value of the real estate collateral (after deducting any more senior liens held by others) is 50 percent or less of the principal amount of the loan at origination, the loan should not be categorized as a loan secured by real estate. Instead, ***the loan should be reported in one of the other loan categories used in these reports based on the purpose of the loan***. (Emphasis added)

Many small business loans have been partially secured by residential real estate thereby disqualifying them from being "reportable" small business loans under CRA. But now the new definition appears to open the door to recognizing a new wave of small business loans that had not been recognized previously. This could have a major impact on the volume of reported small business lending under CRA.

Discussion with regulators at the various bank regulatory agencies suggests that those charged with CRA responsibilities were unaware of the Call Report changes. "Good grief, I wasn't aware of the change", was the initial response of one high level Agency person. GeoDataVision has been told that the subject has been placed on the June Agenda of at least one bank regulatory agency. More to come . . .