
**Office of the Comptroller of the Currency
Federal Deposit Insurance Corporation
Federal Reserve Board
Office of Thrift Supervision**

*Interpretive Letter #714
April 1996
12 U.S.C. 2901*

March 25, 1996

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Dear []:

This letter responds to your correspondence of February 8, 1996, concerning the formation of a community development bank (CDB) in Louisville, Kentucky. As your letter explains, a number of traditional banking institutions (the Banks) have made equity capital commitments to the CDB. The Banks have voiced concern, however, about the effect these investments would have on their Community Reinvestment Act (CRA) evaluations. Along with my counterparts at the Federal Reserve Board (FRB), Federal Deposit Insurance Corporation (FDIC) and Office of Thrift Supervision (OTS), I wish to reassure the Banks that the proposed investments in the CDB would have a positive impact on their CRA evaluations. The following discussion addresses the specific areas of concern raised by the Banks.

I. Community Development Banks

In your letter, you ask whether the federal financial supervisory agencies encourage the support of community development banks by traditional banking institutions. As you know, the CRA was designed to encourage institutions to help meet the credit needs of their entire communities, including low- and moderate-income areas, consistent with safe and sound lending practices. The preamble to the new CRA regulation, which was published May 4, 1995, expressly recognizes bank support of community development banks as a means of meeting community credit needs.

Banks may receive CRA consideration for community development loans to, or investments in, "financial intermediaries" such as community development banks. See 60 Fed. Reg. at 22,160

n.1; *see also* 60 Fed. Reg. at 22,162 n.3.¹ The regulation defines “community development” as: (1) affordable housing for low- or moderate-income individuals; (2) community services targeted to low- or moderate-income individuals; (3) activities that promote economic development by financing small businesses and farms; or (4) activities that revitalize or stabilize low- or moderate-income geographies. 60 Fed. Reg. at 22,179, 22,190, 22,202, and 22,212-3 (to be codified at 12 CFR §§ 25.12(h), 228.12(h), 345.12(h), and 563e.12(g)). If the proposed CDB primarily supports one or more of these activities, examiners will view the Banks’ investments in the CDB favorably during their CRA evaluations.

The new CRA regulation sets out a number of different tests for examiners to use in evaluating CRA performance, depending on the size and business strategy of the institution. Your letter focuses on whether the Banks’ investments in the CDB will receive positive consideration under the regulation’s lending test. The lending test evaluates an institution’s lending activities by considering the institution’s home mortgage, small business, small farm, community development, and in some instances, consumer lending. Among the performance criteria considered in the lending test is an institution’s community development lending, including the number and amount of community development loans and their complexity and innovativeness. *See* 60 Fed. Reg. at 22,181, 22,192, 22,203, and 22,214 (to be codified at 12 C.F.R. §§ 25.22(b)(4), 228.22(b)(4), 345.22(b)(4), and 563e.22(b)(4)). A “community development loan” must have community development as its primary purpose and, except in the case of wholesale or limited purpose banks, must benefit the institution’s assessment area(s) or a broader statewide or regional area that includes the institution’s assessment area(s). *See* 60 Fed. Reg. at 22,179, 22,190, 22,202, and 22,213 (to be codified at 12 C.F.R. §§ 25.12(i)(1) and (2)(ii), 228.12(i)(1) and (2)(ii), 345.12(i)(1) and (2)(ii), and 563e.12(i)(1) and (2)(ii)).

The regulation allows an institution that invests in a community development financial institution, such as the CDB, that uses the institution’s investment to make loans to receive consideration under the lending test for its pro rata share of community development loans made by the entity. *See* 60 Fed. Reg. at 22,181, 22,192, 22,203-04, and 22,215 (to be codified at 12 C.F.R. §§ 25.22(d), 228.22(d), 345.22(d), and 563e.22(d)). An institution that purchases loans from another institution, as opposed to originating the loans directly, will also receive consideration under the lending test. *See* 60 Fed. Reg. at 22,181, 22,192, 22,203, and 22,214 (to be codified at 12 C.F.R. §§ 25.22(a)(2), 228.22(a)(2), 345.22(a)(2), and 563e.22(a)(2)). In the proposal you have described, if a bank elected lending test

¹ For your convenience, attached are the Federal Register sections containing the new CRA regulation, the Interagency Community Reinvestment Act Examination Procedures for Large Retail Institutions, and a recent interagency letter addressing the evaluation of an institution’s investments in a community development bank under the investment and lending test of the new CRA rule.

consideration,² the bank would receive consideration for the amount of community development loans made as a result of its investment in the CDB and for the amount of any such loans that it purchases from the CDB.³

II. Market Share Analysis and Performance Context

Your letter also raises a number of issues concerning market share analysis and performance context under the new CRA regulation. The new CRA regulation is the result of a comprehensive effort by the agencies to reform their standards for evaluating CRA compliance. This reform effort involved the publication, in 1993 and 1994, of proposed revisions to the CRA regulation. Under the 1993 proposal, an institution's lending efforts would have been evaluated principally by comparing its share of reported housing, small business, and consumer loans in low- and moderate-income areas in its service area with its share of such loans in other parts of its service area. Many commenters were concerned, however, that this market share analysis would promote credit allocation because it would not adequately reflect differences among institutions and the communities they serve.

² Alternatively, the Banks may choose to have their investments in the CDB evaluated under the investment test. The investment test evaluates an institution's number and amount of qualified investments, the innovativeness or complexity of its qualified investments, the responsiveness of the qualified investments to credit and community development needs, and the degree to which the qualified investments are not routinely provided by private investors. See 60 Fed. Reg. at 22,181, 22,192, 22,204, and 22,215 (to be codified at 12 C.F.R. §§ 25.23(e), 228.23(e), 345.23(e), and 563e.23.(e)). Qualified investments include investments in community development banks that primarily lend in low- and moderate-income areas or to low- and moderate-income individuals to promote community development. See 60 Fed. Reg. at 22,162 n.3. Finally, the Banks could choose to have part of their investments in the CDB evaluated under the investment test and part under the lending test. See Letter from Matthew Roberts, Director, Community and Consumer Law Division, Office of the Comptroller of the Currency (February 21, 1996) (attached).

³ Some of the Banks have also asked whether they would receive CRA consideration for the sale to the CDB, at market rates, of high-quality commercial loans (other than small business loans) in order to support the CDB by providing it with high quality assets to carry on its books. Ordinarily, examiners would not consider this type of transaction in evaluating an institution's lending, qualified investments or services. However, an institution may provide, and examiners will consider, any information that demonstrates how an institution is helping meet credit needs in its assessment area(s). An institution that believes that a certain transaction helps meet those credit needs should, therefore, bring that transaction to its examiner's attention.

The 1994 proposal responded to these concerns by eliminating the market share analysis as the linchpin of the lending test and by introducing the concept of “performance context.”⁴ “Performance context” describes the type of information about an institution and its community that an examiner must review in order to assess adequately the institution’s performance. This basic demographic and other information about an institution and its community provides the context for evaluating data on an institution’s lending, service, and investment performance. In determining the individual context in which a particular institution’s performance should be evaluated, examiners must review demographic and economic data about the institution’s assessment area(s), and information about local economic conditions, the institution’s major business products and strategies, and its financial condition, capacity, and ability to lend or invest in its community. See 60 Fed. Reg. at 22,180, 22,191, 22,203, and 22,214 (to be codified at 12 C.F.R. §§ 25.21(b), 228.21(b), 345.21(b), and 563e.21(b)). Requiring examiners to consider these factors is consistent with a fundamental underpinning of the new CRA regulation -- that the differences in institutions and the communities in which they do business preclude rigid and inflexible rules.

The lending test of the new rule has five performance criteria, one of which is the geographic distribution of an institution’s loans. See 60 Fed. Reg. at 22,181, 22,192, 22,203, and 22,214 (to be codified at 12 C.F.R. §§ 25.22(b)(2), 228.22(b)(2), 345.22(b)(2), and 563e.22(b)(2)). As part of the geographic distribution analysis, an examiner may include, among other analyses, an analysis of the lending performance of other lenders, if such an analysis would provide accurate insight. This analysis may be useful in reaching a conclusion as to whether an institution’s abnormally low loan penetration in certain areas should constitute a negative consideration. See 60 Fed. Reg. at 22165; see also Interagency Community Reinvestment Act Examination Procedures for Large Retail Institutions at 6. Nonetheless, this analysis is not required and is simply one tool of many that an examiner may use in evaluating one lending test criterion. The new CRA regulation does not require examiners to use any single type of analysis and would not link any particular ratio with a particular lending test rating or overall CRA rating.

The existence of, and the Banks’ support for, the CDB in Louisville are certainly factors examiners would consider as part of the performance context in which to evaluate the Banks’ CRA performance. If the CDB eventually dominates low- and moderate-income lending in parts of the Banks’ assessment areas because of its unique ability to address community development needs, the Banks will not be penalized in their CRA evaluations even though their share of loans made in low- and moderate-income areas may decline. Instead, and for the reasons set forth above, the Banks will receive favorable consideration for their investments in the CDB and for any loans that they purchase from the CDB.

⁴ The 1994 proposal used the term “assessment context.” The final rule changed that term to “performance context” to better describe the role of this information in the CRA evaluation process. See 60 Fed. Reg. at 22,162.

III. Examiner Training

In your letter, you ask how the agencies “intend to cultivate sensitivity on the part of bank examiners to the nuances of performance context.” As discussed above, performance context is a fundamental concept in the new CRA regulation and therefore was discussed extensively in recent examiner training.

In December 1995, the agencies completed the last of five sessions of interagency examiner training. These four-day sessions were held in Dallas, San Francisco, Atlanta, Chicago, and Boston. CRA compliance specialists from all four agencies, including the individuals who drafted the CRA examination procedures, provided instruction in all aspects of the CRA regulations and examination procedures. In addition, the training featured presentations by bankers and other community representatives.

In order to ensure that both new and experienced examiners have adequate training, the agencies will incorporate ongoing CRA training on the revised regulations as a regular component of their consumer compliance training curricula for examiners. If needed, the agencies will also offer specialized CRA training, either individually or on an interagency basis.

I trust this letter has been responsive to your inquiry. You may also be interested to know that the staffs of the four financial supervisory agencies are presently developing written guidance to assist in resolving interpretive questions arising under the new CRA regulation. In the meantime, if you have any further questions, please feel free to call me or Michele Meyer, an attorney on my staff, at (202) 874-5750.

Sincerely yours,

/s/

Matthew Roberts
Director
Community and Consumer Law Division
Office of the Comptroller of the Currency