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Compliance Corner: Small Business Lending and the Community Reinvestment Act (CRA)

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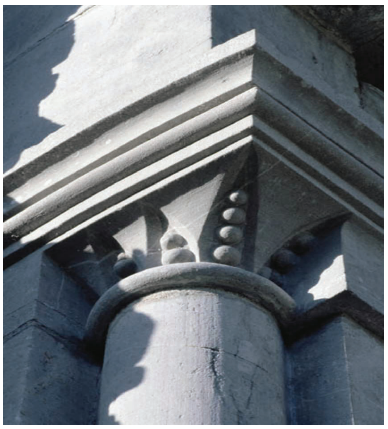

Lending remains the key to satisfactory Community Reinvestment Act (CRA) performance, regardless of the size of your bank. And, small business lending is an important part of this performance. As always, examiners consider a bank's particular performance context when evaluating lending performance.

Small business loans are actually "small loans to businesses," because they are loans of $1 million or less that are made to businesses (see sidebar, below).

Large banks and small loans to businesses

Small loans to businesses are always considered in large bank CRA examinations, according to the regulation, in the lending test. To help examiners consider this lending, large banks collect certain loan data. These data include:

- Loan identification number.
- Loan amount at origination.
- Loan location.
- An indicator of whether a loan was made to a "small business" – generally, a business with gross annual revenues of $1 million or less.

Small banks and small loans to businesses

A small bank examination is primarily a lending review and investments and services are considered at a bank's option. In a small bank CRA examination, examiners determine what types of loan products a bank primarily originated and purchased during the evaluation period. If business loans were one of the primary loan products, examiners will select a sample of business loans to help them perform their analysis of the bank's CRA performance.

Although some differences in the complexity of analysis exist between small and large banks, examiners focus both analyses on how well banks help meet credit needs for businesses in low- or moderate-income geographies and for small businesses. Their analyses include the geographic distribution of loans within the bank's assessment area, as well as the percentage of small loans to small businesses.

Expanded geographic consideration

Banks also may receive positive CRA consideration for originating and purchasing small loans to small businesses, even if they are located outside of the banks' assessment areas. This consideration is realized when such banks have otherwise adequately met the small business credit needs within their assessment areas. (Interagency Q&A __.22(b)(2) & (3) – 4.) Both small banks and large banks can receive this consideration – another good reason to geocode your small loans to small businesses!

Business loans that also meet the purpose of community development

Small loans to businesses that also meet the purpose of community development in the CRA regulation are classified as small business loans, not as community development loans. But, a bank may provide information about such loans to the examiners as "other loan data" and request that they be considered in the CRA examination. Examiners will consider the qualitative impact of these loans in terms of community development and may discuss them in the narrative portion of the public performance evaluation.

Government-guaranteed business loans

Government-guaranteed business loans are treated like other business loans. Those that meet the definition of small business loans will be reported by the large banks and included in the large bank lending test. If business loans were a primary loan product of a small bank, government-guaranteed loans would be included in the population from which a loan sample is chosen. To the extent that the government-guaranteed loans also meet the definition of community development, they would bring additional positive consideration to the bank, as discussed previously. For example, the SBA Certified Development Company section 504 Program loans would be considered as community development loans if they were greater than $1 million. Information on section 504 program loans of $1 million or less can be provided to the examiners as "other loan data."

How else can you help finance small businesses?

Some banks don't have the necessary tools or expertise in-house to make some kinds of small loans to businesses – e.g., micro loans to small, start-up businesses. Because CRA must be accomplished in a safe and sound manner, examiners would not expect such a bank to make loans that would be outside of its capabilities. However, a bank could take another route to help meet these types of credit needs. For example, a bank could make an investment in a nonprofit entity whose primary purpose is to originate micro loans to start-up businesses in its assessment area. Such an investment would be considered a qualified investment. A large bank would receive positive CRA consideration for this under the investment test.

In addition, a small bank also could receive positive CRA consideration for the investment previously mentioned as part of the examiner's review of the bank's *lending* performance. Since this qualified investment would be a "lending-related" qualified investment, the bank could provide information to the examiners about how those micro business loans helped to meet a local credit need that the bank could not otherwise have met. Examiners would consider this qualitative effect in their CRA review.

CRA Credit for Business Loans

Small loans to businesses receive positive CRA consideration under the small bank test and under the lending test for large banks.

Small loans to businesses are:

- Loans of $1 million or less, secured by nonfarm nonresidential properties, and reported in Schedule RC-C, part 1, item 1e of the call reports. They include, for example, loans secured by real estate as evidenced by mortgages or other liens on business and industrial properties, hotels, motels, churches, hospitals, educational and charitable institutions, dormitories, clubs, lodges, association buildings, "homes" for aged persons and orphans, golf courses, recreational facilities, and similar properties.
- Loans of $1 million or less, for commercial and industrial purposes to sole proprietorships, partnerships, corporations, and other business enterprises, whether secured (other than by real estate) or unsecured, single-payment or installment, and reported in Scheduled RC-C, part 1 item 4, "Commercial and industrial loans" of the call reports.

Business loans more than $1 million are community development loans if they meet the definition of community development (CD) in the CRA regulation.

- For example, your local county has developed an informal plan to redevelop certain low-income census tracts by attracting and retaining businesses and jobs. Your bank extends a $1.2 million loan to a business located in one of these low-income census tracts in your assessment area. The loan enables the business to retain a significant number of jobs to low- or moderate-income persons who reside in and near the low-income area. Because this loan helps to retain businesses and residents in the low-income area, it is a CD loan. It helps to revitalize and stabilize the low-income area.
- A bank makes a $2 million loan through the SBA section 504 program. This is a CD loan. [If this loan were $1 million or less, it would be a small loan to a business, but information could be presented to the examiners as "other loan data" for the community development impact of the loan.]
- A bank makes an unsecured loan to a nonprofit organization whose purpose is to originate very small business loans to small businesses. The loan qualifies as a CD loan under the CRA.

Other CRA consideration related to small businesses:

- A bank receives positive consideration under the service test, as a CD service, for providing technical assistance to small business owners. Small business is generally defined as one with gross annual revenues of $1 million or less.