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

Interpretive Letter #710
March 1996
12 U.S.C. 2901

February 21, 1996

[ ]

Dear [ ]:

This letter responds to your request addressed to John Gilliam, Wayne Rickards, Duane Thorkildsen, and Linda Ortega, for an interpretation of the provisions of the newly promulgated Community Reinvestment Act (CRA) regulations that govern consideration in an institution's CRA evaluation of lending by an affiliate. As you know, the four bank and thrift agencies have promulgated substantively identical regulations. Therefore, staff from all of the agencies have considered the issues you raised, and they concur in the opinions expressed in this letter.

You asked whether the regulations permit an institution to have loans originated by an affiliate considered as purchases by the institution even if the affiliate counts the same loans as originations in its own CRA evaluation. The regulations permit a loan to be considered twice -- once as an origination and again as a purchase -- if the loan is actually purchased by an affiliate. However, the regulations do not permit consideration of a single loan by two or more affiliates if no purchase transaction occurs.

The agencies recognize that two constraints set out in the regulation regarding consideration of affiliate loans, if read literally, could have unintended consequences in the case of a group of affiliated institutions that have overlapping assessment areas and are all subject to CRA. The first constraint prohibits more than one institution from counting the same origination or the same purchase. The second constraint requires an institution that elects to count loans in a particular lending category made by an affiliate in an assessment area to count all of the loans in that lending category made in that area by all affiliated institutions. As described in more detail below, in the context of a group of affiliated institutions, each of which is subject to CRA and which share parts of the same assessment area, the constraints are properly read (1) to permit a loan originated by one institution and actually purchased by another to be considered once as an origination and once as a purchase and (2) to require that *each* origination and purchase in the assessment area by an affiliate of the group be considered in the CRA evaluation of *one* of the institutions in the group, but not necessarily that *all* be considered in the evaluation of the *same* institution. However, the method by which loans are allocated among the institutions may not be designed solely to enhance their CRA evaluations.

Discussion

The first constraint on affiliate lending in the regulations provides: "No affiliate may claim a loan origination or loan purchase if another institution claims the same loan origination or purchase." 60 Fed. Reg. 22,156, 22,181, 22,192, 22,203, and 22,214 (May 4, 1995) (to be codified at 12 C.F.R. § 25.22(c)(2)(i), 228.22(c)(2)(i), 345.22(c)(2)(i), and 563e.22(c)(2)(i)).

The agencies intended by this constraint that a loan originated by one institution and actually purchased by an affiliate would be evaluated as two separate events, once as an origination and once as a purchase. For example, if Bank A purchases a loan that was originated by affiliated Bank B, the loan is reported twice, by Bank A as a purchase and by Bank B as an origination. If Bank A elects to have Bank B's lending considered in Bank A's CRA evaluation, the loan is considered twice in that evaluation, once as a purchase and once as an origination. Of course, the loan cannot then be considered in Bank B's CRA evaluation.

A loan will not be considered as both a purchase and an origination, however, if the sale was designed to inflate a bank's CRA assessment. The supplementary material accompanying the final rule explained that "an institution can count as a purchase a loan originated by an affiliate, or count as an origination a loan sold to an affiliate, provided the same loans are not sold several times to inflate their value for CRA purposes." *Id*. at 22,166.

You asked whether this language means that an institution can count as a purchase in its CRA evaluation a loan originated by an affiliate, even if the institution does not actually purchase the loan, and the affiliate counts the loan as an origination in its CRA evaluation. In other words, you asked if Bank A can have loans originated by affiliated Bank B considered as purchases in Bank A's CRA evaluation, even if Bank A does not actually purchase the loans and the loans are considered in Bank B's CRA evaluation. The agencies did not intend to allow this treatment of loans. This treatment would in effect permit the double counting that the first constraint is expressly designed to prohibit.

The second limitation on consideration of loans made by an affiliate provides that "[i]f a bank elects to have the OCC consider loans within a particular lending category made by one or more of the bank's affiliates in a particular assessment area, the bank shall elect to have the OCC consider … all the loans within that lending category in that particular assessment area made by all of the bank's affiliates." *Id*. at 22,181, 22,192, 22,203, and 22,214-15 (to be codified at 12 C.F.R. § 25.22(c)(2)(ii), 228.22(c)(2)(ii), 345.22(c)(2)(ii), and 563e.22(c)(2)(ii)).

A strictly literal reading of the second constraint, in concert with the first constraint's prohibition against double-counting, would create an anomalous situation for a group of affiliated institutions that are each subject to CRA and that have overlapping assessment areas. Under a strict reading of this constraint, an institution's decision to count in its CRA evaluation the loans in a particular lending category made by one affiliate would deprive both that affiliate and its other affiliates of the ability to have the agencies consider any loans in that lending category in their own examinations.

An example may help illustrate the problem. Assume affiliated Banks A and B are also affiliated with Thrift C and Mortgage Company D. All of the affiliated institutions serve Metropolitan Area E. All of the affiliated institutions make home mortgage loans, but the banks and thrift refer all applicants whose loans will be saleable on the secondary market to Mortgage Company D. Assume Bank A elects to have examiners consider Mortgage Company D's home mortgage loans that resulted from Bank A's referrals in Bank A's CRA evaluation. A strictly literal reading of the second constraint would require all mortgage loans made in Metropolitan Area E by Bank B and Thrift C, as well as by Mortgage Company D, to be considered in Bank A's evaluation. Because no loan may be double counted, Bank B and Thrift C would not have any mortgage loans in Metropolitan Area E for examiners to consider in their CRA evaluations.

The agencies did not intend this literal reading, which would deprive insured depository institutions subject to the CRA from receiving consideration for their own loans. The purpose of the second constraint is only to prevent an institution subject to CRA, or group of affiliated institutions subject to CRA, from inflating their CRA performance assessments by selectively requesting consideration of certain loans that would favorably affect their assessments but not other loans of the same type that would unfavorably affect their assessments. Therefore, in the context of a group of affiliated institutions that are each subject to CRA and share parts of the same assessment area, the agencies will not read the constraint to require all loans in a lending category in the assessment area to be considered in the CRA evaluation of only one of the affiliated institutions.

Instead, the agencies will read the constraint to require that each loan in that category in the assessment area made by an affiliate of the group (whether the affiliate is subject to CRA or not) be considered in the CRA evaluation of *one* of the institutions in the group, but not that *all* the loans be considered in the evaluation of the *same* institution. This reading reflects the fact that a holding company may, for business reasons, choose to transact different aspects of its business in different subsidiary institutions. However, the method by which loans are allocated among the institutions for CRA purposes must reflect actual decisions about the allocation of banking business among the institutions and may not be designed solely to enhance their CRA evaluations.

Thus, reconsider the example of affiliated Banks A and B, Thrift C, and Mortgage Company D described above. Bank A may elect to have the home mortgage loans originated by Mortgage

Company D that were based on referrals from Bank A considered in Bank A's CRA evaluation, and Bank B and Thrift C may do the same for loans based on their referrals, subject to two constraints: First, no origination or purchase may be considered twice. Second, every home mortgage loan made by one of the four institutions (including Mortgage Company D) in Metropolitan Area E must be considered in the evaluation of one of the three institutions that are subject to CRA.

I hope that this letter has been responsive to your request. You may also be interested to know that the staffs of the four financial supervisory agencies are presently developing a commentary to provide additional guidance for resolving interpretive issues arising under the new CRA regulation. If you have any questions, or if I can be of further assistance in any way, please feel free to contact me at 202-874-5750.

Sincerely,

/s/

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