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

*Interpretive Letter #715
April 1996
12 U.S.C. 2901*

April 2, 1996

[]

Dear Messrs. [] and []:

This letter responds to your correspondence of February 20, 1996, concerning the treatment under the Community Reinvestment Act (“CRA”) of investments by financial institutions in [] (the “Fund”). Specifically, you have asked whether financial institution investors in the Fund will receive positive consideration as qualified investments under the CRA regulation’s Investment and Community Development Tests for the amounts the institutions invest in the Fund. An investment in the Fund would be considered a qualified investment if the underlying debt securities comprising the Fund collectively primarily promote community development activities.

As you know, the four bank and thrift agencies have promulgated substantively identical CRA regulations. Therefore, staff from all of the agencies have considered the issues you raised, and they concur in the opinions expressed in this letter. Furthermore, this letter discusses only whether lawful* investments in the Fund by federally regulated financial institutions would receive favorable consideration under the CRA regulations. The federal financial institutions regulatory agencies do not endorse particular investment opportunities offered to financial institutions.

The Fund

As your letter and the Private Offering Memorandum (“POM”) dated February 16, 1996, explain, “[t]he Fund’s investment objective is to invest in geographically specific private placement debt securities and to earn a ... return over the life of the Fund The Fund’s

* The CRA and its implementing regulations do not provide authority for institutions to make investments that are not otherwise allowed under Federal laws and regulations.

economic objective is to act as a source of long-term fixed rate capital for people, institutions and communities that do not have full and efficient access to the traditional banking and/or capital markets.” POM at 2. Financial institutions will purchase common stock in the Fund. The minimum financial institution investment will be \$5 million with a six year minimum commitment. When a financial institution decides to invest in the Fund, the institution will designate a selected target region in which the Fund will invest. A target region may include a state, a multi-state region, a portion of a state or the entire United States. The Fund will serve a maximum of eight target regions. Institutions’ returns are paid according to the performance of the Fund’s overall investment portfolio. Institutions, therefore, will be able to make geographically specific commitments and simultaneously receive geographically diverse returns.

According to the information provided, before investing, the Fund will assess the community development infrastructure in all investor targeted regions to determine what economic financing activities, such as grants, loans and other investments, are currently taking place. The Fund will then determine what new investments would be practical, innovative and add value to the targeted communities. The Fund intends that each investment will fill a capital gap and not simply replace existing funding.

Through this process, the Fund will create an actively managed bond portfolio. The portfolio will be comprised of privately placed securities supporting affordable housing, education, small business loan securitizations and other job creating investments in the target regions. The Fund intends to invest up to 50 percent of its total assets (but not less than 25 percent) in securities issued by providers of affordable housing.

Discussion

Under the new CRA regulations, regardless of the assessment method used by examiners, financial institutions can receive positive consideration for making “qualified investments.” “Qualified investment” is defined in the new regulations as:

[A] lawful investment, deposit, membership share or grant that has as its primary purpose community development.

60 Fed. Reg. at 22,180, 22,191, 22,202, and 22,213 (to be codified at 12 C.F.R. §§ 25.12(s), 228.12(s), 345.12(s), and 563e.12(r)). “Community development” is defined as:

- (1) Affordable housing (including multifamily rental 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 businesses or farms that meet the size eligibility standards of 13 CFR 121.802(a)(2) and (3) or have gross annual revenues of \$1 million or less; 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 (to be codified at 12 C.F.R. §§ 25.12(h), 228.12(h), 345.12(h), and 563e.12(g)). The term "primary purpose" is not further defined; however, it is commonly understood to mean that the main purpose of the investment activity is community development.

Large institutions' CRA performance is typically evaluated under the lending, investment and service tests. Examiners consider large institutions' qualified investments under the investment test. See 60 Fed. Reg. at 22,181, 22,192, 22,204, and 22,215 (to be codified at 12 C.F.R. §§ 25.23(a), 228.23(a), 345.23(a), and 563e.23(a)). In a small institution examination, examiners may adjust an institution's loan-to-deposit ratio, if appropriate, based on qualified investments. See 60 Fed. Reg. at 22,182, 22,193, 22,205, and 22,216 (to be codified at 12 C.F.R. §§ 25.26(a)(1), 228.26(a)(1), 345.26(a)(1), and 563e.26(a)(1)). Qualified investments may also be considered to determine if a small institution merits an outstanding CRA rating. See 60 Fed. Reg. at 22,188, 22,200, 22,211, and 22,223 (to be codified at 12 C.F.R. pt. 25 app. A(d)(2), pt. 228 app. A(d)(2), pt. 345 app. A(d)(2), and pt. 563e app. A(d)(2)). The community development test, which is appropriate for institutions designated as wholesale and limited purpose institutions, evaluates, *inter alia*, the number and amount of qualified investments. See 60 Fed. Reg. at 22,182, 22,193, 22,204, and 22,215 (to be codified at 12 C.F.R. §§ 25.25(c)(1), 228.25(c)(1), 345.25(c)(1), and 563e.25(c)(1)). And, finally, institutions evaluated on the basis of a strategic plan must include in their plan how they intend to meet the credit needs of their assessment area(s). They may meet credit needs through lending, *investment*, and/or services, as appropriate. See 60 Fed. Reg. at 22,183, 22,194, 22,205, and 22,216 (to be codified at 12 C.F.R. §§ 25.27(f)(1), 228.27(f)(1), 345.27(f)(1), and 563e.27(f)(1)) (emphasis added).

In the case of a retail institution, a qualified investment must benefit the institution's assessment area(s) or a broader statewide or regional area that includes the assessment area(s). 60 Fed. Reg. at 22,181, 22,192, 22,204, and 22,215 (to be codified at 12 C.F.R. §§ 25.23(a), 228.23(a), 345.23(a), and 563e.23(a)). Wholesale and limited purpose institutions can also receive consideration for qualified investments nationwide if they have adequately addressed community development needs in their assessment area(s). 60 Fed. Reg. at 22,182, 22,193, 22,204-05, and 22,216 (to be codified at 12 C.F.R. §§ 25.25(e), 228.25(e), 345.25(e), and 563e.25(e)).

An investment in the Fund would be a “qualified investment” if the Fund primarily promotes community development. In order for the Fund to satisfy this requirement, the debt securities composing the Fund must, when considered collectively, primarily promote community development activities. In this regard, you should be aware, for example, that a mortgage-backed security is considered a qualified investment only if the entire security primarily funds affordable housing (including multifamily rental housing) for low- or moderate-income individuals. In addition, investments promoting education are “qualified investments” only if they are targeted to low- or moderate-income individuals. Furthermore, institutions should consider the regulation’s geographic limitations on consideration of qualified investments when designating a selected target region in which the Fund will invest. For example, for a retail institution, the selected target region must consist of the institution’s assessment area(s) or a broader statewide or regional area that includes the assessment area(s).

I trust that this letter is responsive to your inquiry. You may be interested to know that the staffs of the four financial supervisory agencies are presently developing written guidance to aid the public in resolving interpretive questions arising under the new CRA regulations. In the meantime, feel free to contact me or Margaret Hesse, an attorney on my staff, at (202) 874-5750 if you have further questions.

Sincerely,

/s/

Matthew Roberts
Director
Community and Consumer Law Division
Office of the Comptroller of the Currency (“OCC”)