

# Regulation BB

## Community Reinvestment

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### Background and Summary

The Community Reinvestment Act (CRA) of 1977 (12 USC 2901), as amended, encourages each insured depository institution covered by the act to help meet the credit needs of the communities in which it operates. The CRA requires that each federal financial supervisory agency assess the record of each covered depository institution in helping to meet the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operations; an agency will take that record into account when deciding whether to approve an institution's application for a deposit facility. The CRA has undergone numerous changes since its inception in 1977. In August 2005, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency (the agencies) jointly adopted significant amendments to the CRA.

Neither the CRA nor its implementing regulations inject hard and fast rules or ratios into the examination or application processes. Rather, the law seeks to evaluate each lender's record while accommodating a lender's individual circumstances. Neither the CRA nor its implementing regulations require financial institutions to make high-risk loans that jeopardize their safety. To the contrary, the law makes it clear that an institution's lending to meet its CRA responsibilities should be conducted within the bounds of safety and soundness. Rebuilding and revitalizing communities through sound lending and good business judgment should benefit both communities and financial institutions.

An institution's capacity to help meet community credit needs is influenced by many factors, including its financial condition and size, constraints on its resources, legal impediments, and local economic conditions that could affect the demand and supply of credit. Examiners must consider these factors when evaluating an institution's performance under CRA. This approach is consistent with a fundamental underpinning of the CRA regulations—that the differences in institutions and the communities in which they do business preclude rigid and inflexible rules. Clear, flexible, and sensible performance criteria that accommodate differences in institutions and their communities, that minimize burden, that promote consistency and objectivity, and that allow examiners to be guided by common sense rather than adherence to

mechanistic procedures are embodied in the CRA regulations and the examination procedures that help to implement them.

For example, the CRA regulations provide different evaluation methods in response to basic differences in institutions' structures and operations. The regulations provide (1) a streamlined assessment method for small institutions that emphasizes lending performance; (2) an assessment method for intermediate small institutions that uses the same lending test used in the small-institution examination method, as well as a flexible community development test; (3) an assessment method for large retail institutions that focuses on lending, investment, and service performance; and (4) an assessment method for wholesale and limited-purpose institutions that is based on community development activities. Further, the regulations give any institution, regardless of its size or business strategy, the choice to be evaluated under a strategic plan. This type of flexibility and customizing should permit institutions to be evaluated fairly and in conformance with their business approach.

### Examination-Burden Reduction

The complementary regulatory themes of flexibility, responsiveness, and objectivity are extended to the examination process as part of an overarching effort to, among other things, reduce the burden of the regulations and the CRA examination on institutions. Indeed, both the regulations and the examination procedures reflect a conscientious effort to minimize the burden on financial institutions. For example, the agencies' conscious attempt to minimize the burden on supervised institutions can be seen in the fact that examiners are encouraged to draw on the results of previous examinations of an institution for information about its major product lines, business strategy, and supervisory restrictions. This information is typically available from agency sources and can often be reviewed off-site. Further, examiners may already have knowledge of an institution's community and local demographics from their own past visits to the institution or to other institutions in the same area. In these cases, examiners should be able to develop a good understanding of the context in which an institution operates before the actual examination begins. Examiners can then supplement and update that understanding upon arrival at the institution. Lastly, it should be noted that there are

no CRA data-reporting obligations for small institutions.

Similarly, the regulations focus on performance-based criteria, not on an institution's processes or documentation alone. Institutions are not to be evaluated on how well they ascertain community credit needs, how well they market and advertise their products, or how actively members of their boards of directors participate in local community organizations or civic groups.

This performance-based focus sets the stage for a constructive, credible, efficient, and unobtrusive examination process that concentrates on results. Both the regulations and the examination procedures promote and establish evaluation methods that are based on reviewing objective data; institutions can also use these methods to measure their own performance. Because examination results are more understandable and more predictable under these performance-based examination procedures, the burden on financial institutions is further minimized.

Rather than a one-size-fits-all examination, separate procedures have been developed for small, intermediate small, and large institutions, as well as for wholesale or limited-purpose institutions and institutions that are operating under an approved strategic plan. Further, examiners are expected to use their common sense to tailor an examination to a particular institution, thereby mitigating the burden on the institution. For example, examiners may be able to perform some procedures in advance of the on-site examination. This tailoring allows examiners to take reasonable steps to reduce the burden on an institution and ensure that the examination process is more understandable for the institution.

## Performance Context

An institution's performance under the regulatory assessment criteria is evaluated in the context of information about the institution, its community, and its competitors. The examiner will review demographic and economic data about the institution's assessment area(s), in addition to 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. Often, this review will be facilitated by gathering information from examinations of other institutions serving the same or similar assessment areas, reviewing information from other recent community contacts, and reviewing information about the assessment area developed cooperatively by the different agencies.

The examiner will also review information an institution chooses to provide about the lending,

investment, and service opportunities in its assessment area(s). The examiner will not, however, require the institution to create such information, nor will the examiner ask for any information other than what the institution may already have developed as part of its normal business practice. An examiner should not evaluate an institution on its efforts to ascertain community credit needs, market its products, geocode its loans, or record CRA-related discussions in its board minutes; an institution should also not be rated on the basis of the quality of any contextual information that it may provide.

## Role of Community Contacts

Interviews with local community, civic, or government leaders can help examiners learn about the community and its economic base, as well as local community development needs and initiatives. Interviews can also help examiners understand public perceptions about how well local institutions are responding to the community's credit needs. An examiner can use information obtained from these interviews to balance his or her understanding of the institution's performance context. Community contact interviews normally take the form of personal meetings, but telephone conversations or larger group meetings may also be appropriate.

Information from community contacts can provide valuable insights to examiners, particularly to those who have relatively little experience or familiarity with an institution's assessment area. Contacts may be made during an examination or prior to the start of an examination. Typically, the examiners responsible for the CRA examination will conduct the interviews. However, whenever possible, the agencies will draw on recent local interviews conducted by other agency staff or by other regulatory agencies that have CRA responsibilities in the area.

## Assessment-Area Considerations

Institutions are required to identify one or more assessment areas within which the agencies will evaluate the institution's performance. In most cases, an institution's assessment area will be the town, the municipality, the county, or some other political subdivision or the metropolitan statistical area (MSA) in which its branches are located and a substantial portion of its loans are made. If an institution chooses, however, its assessment area need not coincide with the boundaries of one or more political subdivisions (e.g., counties, cities, and towns or MSAs), so long as the adjustments to those boundaries reflect the fact that the institution's assessment area(s) would otherwise be too

large for the institution to serve, have an unusual configuration, or include significant geographic barriers. When the assessment area coincides with recognized political subdivisions, or when it has not changed in any way since the previous examination, examiners may not have to conduct a comprehensive reevaluation of the assessment area.

When evaluating an institution's performance, the examiner will use the assessment area designated by an institution, provided the assessment area meets regulatory criteria. Only if the criteria have not been satisfied will the examiner revise the assessment area so that it complies with the regulations. The revisions will be discussed with institution management, and the revised assessment area will be used to evaluate performance. However, unless the assessment area reflects illegal discrimination, examiners will not consider problems with the designation of the assessment area when assigning a rating to the institution.

### Performance Criteria for Small Institutions

Often, the burden of regulations and examinations is most pronounced in small institutions. Their limited financial resources and staffing, in addition to other competitive factors, may influence the way that small institutions meet their CRA responsibilities. In recognition of these factors, the regulations established a streamlined assessment method for small institutions that significantly reduces examination burden. The regulations contain only five performance criteria for small institutions:

1. The institution's loan-to-deposit ratio, adjusted for seasonal variation, and, as appropriate, other lending-related activities, such as loan originations for sale to the secondary markets, community development loans, or qualified investments
2. The percentage of loans and, as appropriate, other lending-related activities located in the institution's assessment area(s)
3. The institution's record of lending to and, as appropriate, engaging in other lending-related activities for borrowers of different income levels and businesses and farms of different sizes
4. The geographic distribution of the institution's loans
5. The institution's record of taking action, if warranted, in response to written complaints about its performance in helping to meet credit needs in its assessment area(s)

In carrying out their examination responsibilities, examiners should exercise common sense when deciding how much material to review and what steps are necessary to reach an accurate and

well-supported conclusion. For example, if an institution's assessment area is composed of only a few geographies, a geographic analysis of loans within the assessment area may be inappropriate or unnecessary. Or, if an institution has analyzed where and to whom it is making loans in its assessment area as part of its business efforts, examiners may be able to validate and then use the institution's analysis rather than conduct a detailed analysis of their own. In other words, when evaluating the performance criteria, examiners should always consider and use available, reliable information.

Similarly, if an institution's loan-to-deposit ratio appears low, the examination procedures ask the examiner to evaluate the institution's lending-related activities, such as loan sales and community development lending and investments, to determine if they materially supplement its lending performance as reflected in its loan-to-deposit ratio. However, such an analysis may not be necessary, or a less extensive analysis may be sufficient if the loan-to-deposit ratio is high.

### Performance Criteria for Intermediate Small Institutions

Intermediate small institutions are evaluated under two component tests: the small-institution lending test and the flexible community development test for intermediate small institutions. The lending test encompasses the same five performance criteria used for small institutions:

1. The institution's loan-to-deposit ratio, adjusted for seasonal variation, and, as appropriate, other lending-related activities, such as loan originations for sale to the secondary markets, community development loans, or qualified investments
2. The percentage of loans and, as appropriate, other lending-related activities located in the institution's assessment area(s)
3. The institution's record of lending to and, as appropriate, engaging in other lending-related activities for borrowers of different income levels and businesses and farms of different sizes
4. The geographic distribution of the institution's loans
5. The institution's record of taking action, if warranted, in response to written complaints about its performance in helping to meet credit needs in its assessment area(s)

The second component test for intermediate small institutions is the community development test that was created as a result of the 2005 regulatory changes. The intermediate-small-institution community development test considers the following four criteria:

1. The number and amount of community development loans
2. The number and amount of qualified investments
3. The extent to which the institution provides community development services
4. The institution's responsiveness through such activities to community development lending, investment, and services needs

Under the community development test, intermediate small institutions will be evaluated on their record of providing community development loans, qualified investments, and community development services under one single component rating, unlike the large-institution evaluation method, which considers and evaluates these three activities separately. Intermediate small institutions are expected to allocate resources among the different categories of community development loans, qualified investments, and community development services that are the most responsive to the community development needs and opportunities in the area. Although the agencies expect intermediate small institutions to generally engage in a combination of community development loans, qualified investments, and community development services, the appropriate levels of these activities are very institution-specific and will be determined by an institution's capacity and business strategy, as well as by the community development needs and opportunities in the area.

As they do when conducting other examination procedures, examiners should exercise judgment and common sense to minimize the burden imposed on an institution by the examination process. However, examiner judgment must be consistent with obtaining a complete and accurate assessment of an institution's performance. For example, examiners may be able to use economic and demographic data that were analyzed in an examination of one institution when they examine other institutions serving the same or similar assessment areas. Information from community contacts may cover more than one institution in a given market. When an institution has analyzed its CRA performance, examiners may use those analyses, after verifying their accuracy and reliability, and should supplement those analyses when questions are raised. Examiners should consider any performance-related information offered by an institution but should not request information not called for by examination procedures.

## Performance Criteria for Large Institutions

Large institutions are evaluated and rated under three separate performance tests: the lending test,

the investment test, and the service test.

### Lending Test

The lending test evaluates a large institution's retail lending, as well as its community development lending, using five performance criteria:

1. The number and dollar amount of the institution's home mortgage, small business, small farm, and consumer loans, if applicable, in the institution's assessment area(s)
2. The geographic distribution of the institution's home mortgage, small business, small farm, and consumer loans, if applicable, based on the loan location
3. The distribution of the institution's home mortgage, small business, small farm, and consumer loans, if applicable, to borrowers of different income levels and businesses and farms of different sizes
4. The number and dollar amount of community development loans and their complexity and innovativeness
5. The institution's use of innovative and flexible lending practices

### Investment Test

The investment test evaluates an institution's record of making qualified investments, using the following four performance criteria:

1. The dollar amount of qualified investments
2. The innovativeness or complexity of qualified investments
3. The responsiveness of qualified investments to credit and community development needs
4. The degree to which the qualified investments are not routinely provided by private investors

### Service Test

The service test evaluates an institution's use of retail and community development services to meet the needs of the assessment area. The institution's retail services are evaluated in the retail service test, which includes four performance criteria:

1. The current distribution of the institution's branches among low-, moderate-, middle- and upper-income geographies
2. The institution's record of opening and closing branches, particularly branches located in low- or moderate-income geographies or primarily serving low- or moderate-income individuals
3. The availability and effectiveness of the institution's alternative systems for delivering services to low- and moderate-income areas and individuals

4. The range of services provided in low-, moderate-, middle-, and upper-income geographies and the degree to which the services are tailored to meet the needs of those geographies

An institution's community development services are considered using the two performance criteria in the community development service test:

1. The extent to which the institution provides community development services
2. The innovativeness and responsiveness of community development services

As mentioned previously under the small-institution and intermediate-small-institution examination procedures, examiners are expected to exercise judgment and common sense to minimize the burden of the examination process, consistent with obtaining a complete and accurate assessment of performance. However, large institutions face burdens that small institutions do not, particularly the burden of data collection and reporting. Nevertheless, because large-institution data exist in an automated form, examiners can conduct much of their necessary analysis before the on-site examination—thereby reducing disruptions caused by the presence of examiners at the institution. As they do in small institutions, examiners must be sensitive to the burden of the examination process and use their judgment and common sense to determine what examination steps are necessary to arrive at an accurate assessment of an institution's performance.

## Performance Criteria for Wholesale or Limited-Purpose Institutions

To be evaluated under the community development test, an institution must be designated as a wholesale or limited-purpose institution. An institution receives this designation by submitting a written request to its primary regulator. Once an institution has received a designation, it will not normally have to reapply for it. The designation will remain in effect until the institution requests that it be revoked or until one year after the agency determines that the institution no longer satisfies the criteria for designation and notifies the institution of this determination.

Wholesale or limited-purpose institutions are evaluated on the basis of their

1. Community development lending, qualified investments, or community development services;
2. Use of innovative or complex qualified investments, community development loans, or community development services and the extent to which investments are not routinely provided by private investors; and

3. Responsiveness to community credit and development needs.

Examiners must be cognizant of the context within which a wholesale or limited-purpose institution operates. Examiners should recognize that these institutions may tailor their community development activities on the basis of their own circumstances and the community development opportunities available to them in their assessment areas or in the broader statewide or regional areas that include the assessment areas.

Institutions need not engage in all three categories of community development activities to be considered Satisfactory under the community development test. Community development loans, investments, and services can be directed to a statewide or regional market that includes the institution's assessment area; these activities still qualify for consideration under the community development test as benefiting the assessment area. Moreover, if an institution has a Satisfactory community development record in its assessment area, all community development activities regardless of their locations should be considered.

In applying the community development test, examiners should perform only those analyses that are necessary to reach an accurate conclusion about the institution's performance; use all available, reliable information; and avoid duplication of effort to reduce the examination burden on an institution.

## Strategic Plans

The regulations permit any institution to develop a strategic plan for addressing its CRA responsibilities. An institution must submit its strategic plan to its primary supervisory agency for approval. The regulations require that the plan be developed in consultation with members of the public and be published for public comment. The plan must contain measurable annual goals. A single plan may contain goals designed to achieve only a Satisfactory rating; at the institution's option, a plan may also contain goals designed to achieve a Satisfactory rating, as well as goals designed to achieve an Outstanding rating.

The strategic-plan approach to addressing an institution's CRA responsibilities presents an opportunity for a very straightforward examination. The first question an examiner should investigate is whether the goals were met. If they were, the appropriate rating should be assigned. The appropriateness of the goals will have already been determined during the public comment period for the plan and as part of the appropriate agency's review and approval of the plan. Consequently,

further investigation relating to the context of the institution should not be necessary. Obviously, if some or all of the plan's goals were not met, the examiner will be required to evaluate issues such as whether the goals were substantially met; in doing so, the examiner will have to exercise some judgment about the degree goals were missed and the causes.

However, an examiner should approach an examination of an institution operating under a strategic plan understanding the primary purpose of the regulatory provisions on strategic plans: to give an institution significant latitude to design a program that is appropriate to its own capabilities, business strategies, and organizational framework, as well as to the communities it serves. Consequently, the institution may develop plans for a single assessment area that it serves; for some, but not all, of the assessment areas that it serves; or for all of them. It may also develop a plan that incorporates and coordinates the activities of

various affiliates. The examiner's challenge is to evaluate institutions operating under one plan or under a number of plans in a way that accurately reflects the results achieved and that sensibly wraps that evaluation into the overall assessment of the institution.

Again, an examiner should, to the greatest extent possible, use information available from the agencies to evaluate an institution's performance under a strategic plan. However, it is likely that some elements of a plan under review will not be reflected in public or other agency data. Consequently, the examiner may, of necessity, have to ask the institution for the data necessary to determine whether it has met its goals. To the extent possible, the examiner should ask the institution to provide data for review before the on-site portion of the examination. The examiner should also seek to mitigate the burden on the institution by, wherever possible, using data in the form maintained by the institution.