Office of Inspector General

March 2007
Report No. 07-008

FDIC's Implementation of the 2005 Amendments to the Community Reinvestment Act Regulations

AUDIT REPORT

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Background and Purpose of Audit

The purpose of the Community Reinvestment Act of 1977 (CRA) was to encourage depository institutions to help meet the credit needs of the communities in which they operate, including low- and moderate-income neighborhoods, consistent with safe and sound banking practices. The CRA has come to play an important role in improving access to credit among under-served rural and urban communities.

The CRA requires that each insured depository institution's record in helping meet the credit needs of its entire community be periodically evaluated and publicly reported. In 2005, the federal banking agencies amended their CRA regulations which created a new class of small institutions (intermediate small banks, or ISBs) with reduced CRA reporting requirements and more flexibility in meeting CRA goals.

The objective of the audit was to determine whether the FDIC has (1) issued institution and examination guidance that addresses the 2005 amendments to the CRA regulations and (2) established outcome-oriented performance measures to determine if the amended regulations have provided the intended regulatory relief for smaller community banks and preserved the importance of community development.

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Results of Audit

The FDIC has issued institution and examination guidance that addresses the 2005 amendments to the CRA regulations. The institution guidance was supplemented with interagency questions and answers guidance in March 2006. Our review of 10 ISB Performance Evaluation (PE) reports found that examiners had generally followed the new examination procedures, using the lending and community development tests to assess ISBs. However, we noted one area where examiner guidance could be improved regarding the implementation of the ISB community development test and the presentation of the results in the PE reports to support test conclusions.

Specifically, the level of information and analysis required by the guidance and presented in the PE reports could be expanded in the following areas to more fully support the examiners' conclusions: the recognition of the number and dollar amounts of community development activities, the determination of opportunities for community development, and the placement of community development activities in the context of a bank's capacity. Further, comparative measures could be incorporated into the analysis to improve support and public understanding of conclusions reached in the PE reports. The absence of this information limits the usefulness of the PE reports to the community and can reduce a community's understanding of a bank's CRA activities. Community understanding and use of the PE reports is key to ensuring that community needs in terms of loans, investments, and services are being met.

Additionally, while it may be premature to establish outcome-oriented performance measures for the amendments made to the CRA regulations, the FDIC has not developed a strategy to determine whether the 2005 amendments to the CRA regulations have provided the intended regulatory relief for smaller community banks and preserved the importance of community development. Such a strategy will position the FDIC to proactively assess the impact of the amendments made to the CRA regulations.

Recommendations and Management Response

The report recommends that the Director, DSC, (1) enhance examiner guidance to ensure examiners provide complete support in the PE reports for their conclusions for the community development test, (2) develop examiner guidelines that incorporate the use of comparative measures within the performance analysis, and (3) develop a strategy for measuring CRA activities as a result of the amendments made to the regulations to assist the FDIC in determining if the amendments have provided the intended regulatory relief for smaller community banks and preserved the importance of community development in the CRA examinations of these banks. DSC management agreed to implement the first recommendation and will raise the second and third recommendations with the other federal banking agencies for interagency discussion and consideration. Management's planned actions are responsive to our recommendations.

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ACRONYMS

APA	Administrative Procedure Act
C.F.R.	Code of Federal Regulations
CPO	Corporate Performance Objective
CRA	Community Reinvestment Act
DSC	Division of Supervision and Consumer Protection
EGRPRA	Economic Growth and Regulatory Paperwork Reduction Act of 1996
FFIEC	Federal Financial Institutions Examination Council
FIL	Financial Institution Letter
FRB	Board of Governors of the Federal Reserve System
GAO	Government Accountability Office
GPRA	Government Performance and Results Act
ISNB	Insured State Nonmember Bank
ISB	Intermediate Small Bank
OCC	Office of the Comptroller of the Currency
PE	Performance Evaluation
RD	Regional Directors
U.S.C.	United States Code

DATE: March 30, 2007

MEMORANDUM TO: Sandra L. Thompson, Director
Division of Supervision and Consumer Protection

/Signed/
FROM: Russell A. Rau
Assistant Inspector General for Audits

SUBJECT: *FDIC's Implementation of the 2005 Amendments to the Community Reinvestment Act Regulations*
(Report No. 07-008)

This report presents the results of our audit of the FDIC's implementation of the 2005 joint final rule that amended certain provisions of the FDIC, Board of Governors of the Federal Reserve System (FRB), and Office of the Comptroller of the Currency (OCC) (collectively, the federal banking agencies) regulations implementing the Community Reinvestment Act (CRA). The CRA was enacted to encourage depository institutions to help meet the credit needs of the communities in which they operate, including low- and moderate-income neighborhoods, consistent with safe and sound banking practices. In 2005, significant amendments were made to the CRA regulations to provide regulatory relief for smaller community banks and preserve the importance of community development[1] in the CRA examinations of these banks.

The objectives of the audit were to determine whether the FDIC has (1) issued institution and examination guidance that addresses the 2005 amendments to the CRA regulations and (2) established outcome-oriented performance measures to determine if the amended regulations have provided the intended regulatory relief for smaller community banks and preserved the importance of community development. We focused our audit on intermediate small banks (ISB).[2] We selected a limited sample of CRA Performance Evaluation (PE) reports[3] prepared by FDIC examiners to gain an understanding of the manner in which the amended CRA regulations have been implemented. Appendix I of this report discusses our audit objectives, scope, and methodology in detail.

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[1] Community development is defined in Part 345 of the FDIC Rules and Regulations 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 small businesses or farms; or (4) activities that revitalize or stabilize low- or moderate-income geographies, designated disaster areas, or distressed or underserved nonmetropolitan middle-income geographies.
[2] ISBs - banks with assets of at least $250 million as of December 31 for both of the prior 2 calendar years and less than $1 billion as of December 31 for either of the prior 2 calendar years.
[3] PE reports have been made public since July 1, 1990.

BACKGROUND

The CRA requires that each insured depository institution's record in helping to meet the credit needs of its entire community be periodically evaluated and publicly reported. Part 345, *Community Reinvestment*, of the FDIC Rules and Regulations, which implements the CRA, requires the FDIC to periodically conduct CRA examinations of FDIC-supervised institutions. Upon conclusion of an examination, the agency must prepare a written evaluation of the institution's CRA performance record in a PE report. This written evaluation is public information and can be obtained through the institution or its supervisory agency. While the content of the public evaluation might vary, depending on the nature of the institution examined and the assessment method used, the PE report generally has the following information: (1) the institution's CRA rating,[4] (2) a description of the financial institution, (3) a description of the financial institution's assessment areas, and (4) conclusions regarding the financial institution's CRA performance, including the facts, data, and analyses that were used to form such conclusions. The CRA performance rating does not reflect an institution's financial condition but deals strictly with how well the institution is meeting its responsibilities under the CRA.

Amendments to the CRA Regulations

Amendments to certain provisions of the CRA regulations took effect on September 1, 2005. The amendments created a new class of institutions for CRA purposes, ISBs, with at least $250 million in assets but less than $1 billion, without consideration of holding company affiliation, and included an annual inflationary adjustment based on changes to the Consumer Price Index. For these ISBs, formerly examined under large bank CRA examination procedures, the amended regulations:

- Eliminated CRA loan data collection and reporting requirements after September 1, 2005. However, examiners will continue to evaluate bank lending activity in the CRA examinations of these institutions and disclose the results in the publicly-available PE reports.

- Replaced the lending, investment, and service tests with two separately-rated tests: the existing lending test for small banks and a new, flexible community development test. However, the regulations continue to allow small banks, including ISBs, to opt for an examination under the lending, investment, and service tests for large banks, provided that the data are collected.

Appendix III of this report provides a comparison of large bank examination procedures to ISB procedures.

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[4] The FDIC rates the financial institution's overall CRA performance using a four-tiered rating system. The four ratings, Outstanding, Satisfactory, Needs to Improve, and Substantial Noncompliance, are defined in detail in Appendix II of this report.

For banks of any size, the amended regulations:

- Expanded the definition of community development to include activities[5] that revitalize and stabilize “underserved and distressed” rural areas, as well as designated disaster areas.

- Clarified when discrimination and other illegal credit practices by a bank or an affiliate will adversely affect a bank’s CRA performance.

Based on data compiled by the Federal Financial Institutions Examination Counsel (FFIEC) for 2005, the number of institutions reporting community development loans fell sharply from 1,280 to 813 (36 percent) because of the rule changes exempting institutions with assets of less than $1 billion from reporting. However, the dollar volume of such lending was little changed from $51.2 billion to $52 billion.

Institution and Examination Guidance

Part 345 of the FDIC’s Rules and Regulations, as revised in 2005, requires the FDIC to evaluate the record of an ISB in helping to meet the credit needs of its assessment area(s) pursuant to a lending test and a community development test. The lending test is evaluated pursuant to the following performance factors:

- the loan-to-deposit ratio,
- loan concentration within the assessment area(s),
- loan distribution based on borrower characteristics,
- loan distribution based on geographic location, and
- the bank’s responsiveness to substantiated complaints.

The community development test is evaluated pursuant to the following performance factors:

- the number and amount of community development loans;[6]
- the number and amount of qualified investments;[7]
- the extent to which the bank provides community development services;[8] and
- the bank’s responsiveness through such activities to community development lending, investment, and service needs.

[5] Loans, investments, or services with a primary purpose of community development.
[6] Part 345 defines a community development loan as a loan that has community development as its primary purpose and that has not been reported by the bank for consideration in the bank’s assessment (within the lending test) as a home mortgage, small business, small farm, or consumer loan, unless it is a multifamily dwelling loan; and that benefits the bank’s assessment area(s) or a broader area that includes the bank’s assessment area(s).
[7] Part 345 defines a qualified investment as a lawful investment, deposit, membership share, or grant that has community development as its primary purpose.
[8] Part 345 defines community development service as a service that has community development as its primary purpose, is related to the provision of financial services, and has not been considered in the evaluation of the bank’s retail banking services.

The conclusions reached, based on the results of the two tests, depend on the bank's capacity[9] for such lending and community development activities, the needs of its assessment area(s), and the availability of such opportunities[10] for lending and community development.

The FDIC issued guidance on the revised CRA regulations in the form of Financial Institution Letters (FIL) and Regional Directors (RD) Memoranda. The FDIC notified the institutions it supervises of the amended CRA regulations through FIL-79-2005, *Community Reinvestment Act: Joint Final Rules*, and of the ISB examination procedures through FIL-33-2006.[11] The FDIC's Division of Supervision and Consumer Protection (DSC), which is responsible for implementing the CRA examination process for the FDIC, notified its examiners of the ISB examination procedures through RD Memorandum 05-032.[12] These procedures were issued by the federal banking agencies and posted to the FFIEC's Web site. Additionally, the FDIC issued supplementary guidance in the form of questions and answers (see Appendix IV for a complete list of FDIC institution and examination guidance related to the CRA amendments).

Based on our review of the evaluation requirements in Part 345 for the community development test and the FFIEC PE reporting requirements that the facts, data, and analyses used to form conclusions about the rating must be reflected in the PE report (discussed later), we have determined that examiners are required to present certain analytical information in PE reports. These requirements are discussed in the following sections.

RESULTS OF AUDIT

The FDIC has issued institution and examination guidance that addresses the 2005 amendments to the CRA regulations. The institution guidance was supplemented with draft interagency questions and answers guidance in November 2005 and finalized in March 2006. In addition, our review of 10 ISB PE reports found that examiners had used the lending and community development tests to assess ISBs and that examiners had generally followed the new examination procedures. However, we noted that examiner guidance could be improved in relation to the implementation of the ISB community development test and the presentation of the results in the PE reports to support test conclusions.

Specifically, the level of analysis required by the guidance and presented in the PE reports could be expanded in the following areas to more fully support the examiners' conclusions: the recognition of the number and dollar amounts of community development activities, the determination of opportunities for community development, and the placement of community development activities in the context of a bank's capacity. Further, comparative measures could be incorporated into the analysis to improve support and public understanding of conclusions reached in the PE reports. The absence of this information reduces the usefulness of the PE reports to the community and can

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[9] In relationship to banking, capacity is the financial, legal, and managerial ability to provide a certain type of product or service.

[10] In relationship to banking and CRA, opportunity is the need for, or availability to participate in, a certain type of product or service that meets a specific lending or community development need within a bank's assessment area(s).

[11] Entitled, *Community Reinvestment Act Interagency Examination Procedures*, April 10, 2006.

[12] Entitled, *Interagency CRA Examination Procedures for Intermediate Small Institutions*, August 16, 2005.

reduce a community's understanding of a bank's CRA activities. Community understanding and use of the PE reports are key to ensuring that community needs in terms of loans, investments, and services are being met **(Community Development Test)**.

Additionally, while it may be premature to establish outcome-oriented performance measures for the amendments made to the CRA regulations, the FDIC has not developed a strategy to determine whether the 2005 amendments to the CRA regulations have provided the intended regulatory relief for smaller community banks and preserved the importance of community development. Such a strategy will position the FDIC to proactively assess the impact of the amendments made to the CRA regulations **(Measuring the Impact of the 2005 Amendments)**.

COMMUNITY DEVELOPMENT TEST

Based on our review of 10 ISB PE reports from 4 DSC regions, we found that examiners had consistently provided support for conclusions on the lending test but often did not provide the same level of support for conclusions on the community development test. The ISB examination procedures for the lending test require the use and analysis of ratios, comparative analysis of similarly-situated institutions (or customized peer group averages),[13] and comparative analysis of loan distribution by geographic location and borrower characteristics. The bank's performance, as presented in the PE report, showed loan totals and ratios by number and dollar amount for various loan distribution categories. In addition, if bank management provided certain loan data, the bank's performance was further detailed by year. This information builds a supporting foundation for examiner conclusions on the lending test. However, similar detailed procedural requirements do not exist in the guidance for the community development test, which focuses on community development loans, investments, and services. As a result, support in the PE report for the overall conclusions for the community development test is limited and could be improved (see Appendix V for our detailed analysis). The need for comprehensive support for conclusions in the PE report is heightened by the fact that PE reports are used by the public and community groups in understanding bank performance in the community. PE reports that contain comprehensive support for examiner conclusions on community development will make the reports more informative to these users.

Community Development Test Guidance

Part 345 of the FDIC's Rules and Regulations, as revised in 2005, requires the FDIC to evaluate the record of an ISB in helping to meet the credit needs of its assessment area(s) pursuant to a lending test and a community development test. The community development test is evaluated pursuant to the following performance factors:

- the number and amount of community development loans;

[13] Similarly-situated institutions are financial institutions that serve the same or similar assessment area(s) and that are similar to the bank being examined in terms of size, financial condition, product offerings, and business strategy. Customized peer group averages are the computed performance ratio averages of those similarly-situated institutions.

- the number and amount of qualified investments;
- the extent to which the bank provides community development services; and
- the bank's responsiveness through such activities to community development lending, investment, and service needs.

The FDIC issued RD Memorandum 05-032 to transmit the FFIEC's ISB examination procedures for the community development test, which require that examiners identify and form conclusions about the number and amount of the institution's community development loans, qualified investments, and community development services. The RD Memorandum also requires FDIC examiners to review (1) any information a bank may provide, including the results of any assessment of community development needs or opportunities conducted by the bank, and (2) CRA performance context information obtained by examiners from community, government, civic, or other sources.

In addition, the FFIEC ISB examination procedures require that examiners formulate and document a bank's CRA performance context as it relates to "Opportunity" and "Capacity" by reviewing:

- relevant demographic, economic, and loan data;
- Consolidated Reports of Condition (Call Reports), Uniform Bank Performance Reports, annual reports, supervisory reports, and prior CRA examinations of the institution;
- any information provided by the institution about its local community and economy, including community development needs and opportunities, its business strategy, its lending capacity, or other information that assists in the examination of the institution;
- community contact(s) information;
- public comments since the last CRA examination; and
- public evaluations and other financial data for the existence of similarly-situated institutions (in terms of size, financial condition, product offerings, and business strategy) that serve the same or similar assessment area(s).

When presenting conclusions in PE reports with respect to CRA performance tests, the FFIEC guidance for ISB PE reports instructs examiners to:

> Discuss the institution's CRA performance. The facts, data, and analyses that were used to form a conclusion about the rating must be reflected in the PE report. The narrative should clearly demonstrate how the lending and the community development test, and their respective performance criteria, as well as relevant information from the performance context, factored into the institution's rating.

While the objective to evaluate the record of an ISB in helping to meet the credit needs of the bank's assessment area(s) is the same for both the lending test and the community development test, the FFIEC's guidance provided for the lending test is more comprehensive than the guidance provided for the community development test as discussed in the following sections.

Examiner Support for Conclusions in PE Reports

OIG Comparison of PE Report Results for the Lending and Community Development Tests

The level of information and analysis presented in the 10 PE reports sampled was broader and more comprehensive for the lending test than for the community development test. We compared the results of the lending test and the community development test in the 10 reports and found that the PE reports documented the institutions' ratings, included descriptions of the institutions and their assessment areas, contained overall conclusions, and provided a certain level of support for both the lending test and community development test. However, the level of support for examiner conclusions on the lending test was more detailed than the level of support for examiner conclusions on the community development test.

In addressing the lending test's performance factors, as discussed in the *Background* section of this report, examiners used and analyzed loan totals and ratios, performance measures of similarly-situated institutions, and comparative loan distribution measures that incorporated the concepts of capacity and opportunity. In contrast, support in the PE report for the community development test did not always include required information on the number and dollar amounts of community development activities, the determination of opportunities for community development, and the placing of community development activities into the context of the bank's capacity. In addition, the analysis did not include comparative measures, such as the bank's own historical level and trend of performance or customized peer group reviews. As a result, unlike the conclusions reported for the lending test, the PE reports did not always provide comprehensive support for examiner conclusions for the community development test.

Similar to the analysis of the lending test, the community development test analysis is required to incorporate the consideration of the following information:

- Performance in providing community development activities. For example, the lending test utilizes tables to summarize loan data and to provide the total number and amounts of loans under review. While the 10 PE reports did not present complete loan listings for the lending test, the reports did provide consistent summaries describing, for example, the breakdown of the loan portfolio and the distribution of certain loans. In addition, annual performance totals and ratios were provided, when available.

- Opportunities for community development. For example, the lending test quantifies the potential level of lending opportunity available by providing the percentages of low- and moderate-income families and census tracks within the bank's assessment area(s).

- The bank's capacity to provide for community development activities. For example, the lending test uses and analyzes indices, such as the loan-to-deposits ratio and the percentage of loans originated within the bank's assessment area(s), as measures of capacity, in which low percentages may indicate excess capacity and a low level of performance.

To provide an analytical perspective, as provided for in the lending test, the analysis for the community development test could also routinely incorporate the following information:

- The consideration of comparative measures in assessing the bank's community development performance. For example, the lending test uses customized peer group averages of similarly-situated institutions to comparatively assess the bank's loan-to-deposit ratio, and the test uses percentages of low- and moderate-income families and census tracks to comparatively assess the bank's loan distribution.

While both tests share the same institution and assessment area(s) descriptions, which provide the initial descriptions of the bank's performance context as it relates to capacity and opportunity, the lending test incorporates additional information to supplement and support the institution's performance and context. Also of note, the use of formulated and comparative ratios serves many purposes, including the illustration and determination of an institution's performance, opportunity, and capacity. Table 1, on the next page, summarizes the results of our review of the 10 PE reports.

Table 1: Comparison of Data Collection and Analysis Provided in PE Reports for the Lending and Community Development Tests[a]

Analytical Measures	Lending Test	Community Development Test
Determination of Performance		
Summary Listing/Description	Always Provided	Always Provided
Complete Listing	Never Provided	Sometimes Provided
Total Numbers	Always Provided	Sometimes Provided
Total Dollar Amounts	Always Provided	Usually Provided
Annual Totals (If available)	Always Provided	Rarely Provided
Formulated Ratios	Always Provided	Rarely Provided
Comparative Ratios (If available)	Always Provided	Never Provided
Determination of Opportunity		
Bank's Own Assessment	Rarely Provided[b]	Rarely Provided
Examiner's Economic and Demographic Assessment	Always Provided	Sometimes Provided
Activities of Similarly-Situated Institutions	Always Provided	Rarely Provided
Statements of Community Contacts	Always Provided	Always Provided
Statements of Public Comments	Always Provided	Inconclusive[c]
Formulated Ratios	Always Provided	Never Provided
Comparative Ratios	Always Provided	Never Provided
Determination of Capacity		
Formulated Ratios	Always Provided	Rarely Provided
Comparative Ratios	Always Provided	Never Provided

Source: OIG analysis of 10 PE reports.
[a] Legend: Always Provided = 10 PE reports, on average, provided the analytical measure; Usually Provided = 8-9 PE reports, on average, provided the analytical measure; Sometimes Provided = 4-7 PE reports, on average, provided the analytical measure; Rarely Provided = 1-3 PE reports, on average, provided the analytical measure; Never Provided = None of the 10 PE Reports provided the analytical measure.
[b] While not addressed separately within this report, improvement is needed in obtaining and documenting bank management's own assessment of lending opportunities within its assessment area(s).
[c] Only 1 of the 10 PE reports noted the presence of public comments, so we could not conclusively determine if examiners are using this information to formulate potential community development opportunities. Regardless, we were able to conclude on the use of public comments within the lending test due to examiners' comments concerning the bank's responsiveness to substantiated complaints, which is a lending test performance factor.

Recognition of Community Development Activities

As part of the community development test, examiners are required to identify and present within the PE report a bank's level of performance in providing community development loans, investments, and services. In particular, this information forms the foundation of what will be assessed and, potentially, how the institution will be rated. For the 10 PE reports reviewed, the listing of activities presented for community development loans, investments, and services was not always complete; and while not required by the ISB examination procedures, the information did not always include an annual breakdown of the numbers and dollar amounts of these activities.

Specifically, we noted that the PE reports typically provided summary descriptions and listings of the bank's community development activities; however, some PE reports did not provide the total number and/or dollar amount of each activity. We also noted that some of the PE reports did not provide complete listings of community development activities. PE reports that provided summary descriptions and/or complete listings of community development activities, including the total number and dollar amount of community development loans and investments and the total number of community development services, offered public users a comprehensive presentation of these activities. However, public users of PE reports that did not include such comprehensive information may have difficulty understanding the examiner's conclusions or the support for those conclusions. Table 2 summarizes the results of our review.

Table 2: Review of the Identification of Community Development Activities

Level of Data Collection and/or Analysis Presented in PE Reports	No. of PE Reports That Provided Information
PE Reports That Addressed Community Development Loans	
Provided Description of Community Development Loans	10
Provided Complete Listing of Community Development Loans	8
Provided Number of Community Development Loans	8
Provided Dollar Amount of Community Development Loans	10
Provided Annual Breakdown of Number and Dollar Amounts	2
PE Reports That Addressed Community Development Investments*	
Provided Description of Community Development Investments	10
Provided Complete Listing of Community Development Investments	5
Provided Number of Community Development Investments	4
Provided Dollar Amount of Community Development Investments	9
Provided Annual Breakdown of Number and Dollar Amounts	1
PE Reports That Addressed Community Development Services	
Provided Description of Community Development Services	10
Provided Complete Listing of Community Development Services	6
Provided Number of Community Development Services	1
Provided Annual Breakdown of Number	0

Source: OIG analysis of DSC's PE reports.

* One bank did not have any community development investments. Based on our analysis of the PE report for this bank, we concluded that the examiner would have provided consideration for the investments similar to that provided for community development loans and services. We assigned full credit to the various categories rated above except for the community development investment category entitled, *Provided Annual Breakdown of Number and Dollar Amounts*. In particular, the examiner did not provide for the corresponding category in presenting community development loans and services.

Determination of Opportunities for Community Development

As part of the community development test, examination procedures require examiners to determine the level and type of community development opportunities that are available or needed within a bank's assessment area(s) based on the data obtained from various sources of information. For example, demographic and economic data may suggest the need for low-income housing. As a result, the bank may have an opportunity to participate in funding housing that provides ownership or rental opportunities for low- and moderate-income individuals and families. However, the level of reporting and analysis of community development opportunities as presented within the 10 PE reports we reviewed was not always complete. We noted that the PE reports provided detailed descriptions of the bank's assessment area(s) and typically provided an overall statement of conclusion that included a consideration of the opportunity for community development. In addition, all 10 PE reports provided some description of opportunity based on the statements made by the community contacts. However, many PE reports did not present an analysis of the opportunities for community development based on:

- the institution's own assessment of community development needs and opportunities,
- the examiner's analysis of economic and demographic data, and
- the community development activities of similarly-situated institutions.

For six PE reports, the determinations of opportunity for community development appear to have been based primarily on the statements made by the community contacts. Complete information provided in the PE reports allows the reader to better understand the conclusions reached by the examiner. To ensure that the examiners include this information, the CRA examination guidance should clearly instruct examiners how to formulate, evaluate, and/or present the determination of community development opportunity and need. This information would be useful to a reader in understanding how the examiners developed their conclusions in the PE report. Table 3, on the next page, summarizes the results of our review.

Table 3: Review of the Determinations of Opportunity for Community Development

Level of Data Collection and/or Analysis Presented	No. of PE Reports That Provided Information
Provided Description of the Assessment Area(s)	10
Provided Description of Opportunity Based on the Bank's Own Assessment	2
Provided Description of Opportunity Based on the Examiner's Economic and Demographic Assessment	4
Provided Description of Opportunity Based on the Activities of Similarly-Situated Institutions[a]	2
Provided Description of Opportunity Based on the Statement of a Community Contact	10
Provided Description of Opportunity Based on Public Comments[b]	Inconclusive
Provided Overall Conclusion on the Assessment Area(s) Opportunities (For example, the PE report noted that the opportunity level was high or low.)	8
Provided Consideration of Opportunity Within a Statement of Conclusion – the Rating Assignment	9

Source: OIG analysis of DSC's PE reports.
[a] Nine PE reports identified similarly-situated institutions. One PE report stated that there was no similarly-situated institution. However, seven of the nine PE reports did not use similarly-situated institutions to formulate potential community development opportunities, despite this information's availability.
[b] Nine PE reports identified, within the Lending Test, that no public comments were noted. One PE report identified that public comments had been received concerning the bank's payday lending practices. While concerns were noted regarding certain payday lending practices, the details of the public comments were not discussed or analyzed for potential community development opportunities. Since only 1 of the 10 PE reports we reviewed noted the presence of public comments, we could not conclusively determine if examiners are using this information to formulate potential community development opportunities.

Determination of Bank Capacity

As part of the community development test, the CRA regulations and examination procedures require examiners to assess a bank's performance and responsiveness in meeting the needs and opportunities of its community based on the bank's capacity (legal, financial, and managerial ability to provide a certain type of product or service). However, the level of reporting and analysis on the bank's capacity, as presented within the 10 PE reports we reviewed, was not always complete. While examination guidance does not clearly instruct examiners in how to perform this assessment, examiners could provide and assess performance ratios that illustrate the bank's level of response in relationship to its financial ability.

We noted that the PE reports provided detailed descriptions of the institutions and that the examiners typically concluded on the banks' legal and financial ability to meet the credit needs of its assessment areas. In addition, the PE reports typically provided an overall statement of conclusion that included consideration of the bank's capacity. However, for the reader to better understand the conclusions drawn by the examiner, the level of community development activity should be placed into a context that is reflective of the bank's capacity and responsiveness. For PE reports that provided a quantitative description, examiners used ratios such as Community

Development Loans to Net Loans and Community Development Investments to Total Investment. These PE reports provide a better illustration of the bank's capacity, and the ratios enable the reader to better understand the bank's performance and responsiveness. Table 4 summarizes the results of our review.

Table 4: Review of the Determinations of Capacity for Community Development

Level of Data Collection and/or Analysis Presented	No. of PE reports That Provided Information
Provided a Description of the Institution	10
Provided a Description of Lending Performance to the Bank's Capacity[a]	2
Provided a Description of Investment Performance to the Bank's Capacity[b]	3
Provided an Overall Conclusion on the Institution's Capacity[c] (For example, the PE report noted that the bank had capacity to fund loans or participate in community development activities.)	9
Provided Consideration of Capacity Within an Overall Statement of Conclusion – the Rating Assignment	8

Source: OIG analysis of DSC's PE reports.
[a] The description of capacity was illustrated through the ratio of Community Development Loans to Net Loans.
[b] The description of capacity was illustrated through such ratios as Community Development Investments to Total Investments and Community Development Investments to Total Assets. In addition, one bank did not have any community development investments. No credit was assigned because the examiner did not provide for that category in presenting community development loans.
[c] The overall conclusions on capacity were typically phrased as the bank "has no legal or financial impediments that would prevent it from meeting the assessment area(s) credit needs."

Development and Use of Comparative Measures

As part of the community development test, examiners are not required to but could assess a bank's community development performance against comparative measures, such as the bank's own historical level and trend of performance and the performance of customized peer group averages. Based on our review of 10 PE reports, we found that examiner analyses lacked comparative measures of each bank's own level and trend of community development performance and of customized peer group averages, which are needed to perform a comprehensive analysis of the bank's performance level.

RD Memorandum 05-032, dated August 16, 2005, requires examiners to evaluate a bank's responsiveness to community development needs, while considering the institution's performance context. An institution's performance context is formulated, in part, by a review of Call Reports, Uniform Bank Performance Reports, prior performance evaluations, and performance evaluations of similarly-situated institutions. However, we noted that the PE reports did not provide any comparative measures as part of the examiner's assessment of a bank's community development activities, despite evaluating the bank's performance over an aggregated period of 2 to 6 years and despite the recognition of similarly-situated institutions within the bank's assessment area(s).

While certain comparative components, such as community development loans and investments, are not reportable in the Call Reports and are not available in the Uniform Bank Performance Reports, examiners could perform comparisons to the performance levels contained in the most recent PE reports of similarly-situated institutions. Examination guidance requires examiners to identify and evaluate these similarly-situated institutions when formulating a bank's performance context, and the information would be easily obtainable. In order to provide a more informative PE report, an institution's performance could be analyzed against comparative measures, such as the bank's own level and trend of performance and customized peer group averages. This approach would provide report users the information they need to understand the bank's context and level of performance in relation to itself and other banks.

The noted variances within the PE reports appear to be the result of the general guidance provided to examiners for performing the examination and preparing the PE reports. The guidance requires that examiners consider, and document within the PE report, the following information:

- <u>The total number and dollar amount of community development activities.</u> However, the guidance does not clearly instruct examiners in how to present and analyze the level (number and dollar amount) of community development activities.
- <u>The institution's performance within the context of the opportunities available within the bank's assessment area(s).</u> However, the guidance does not clearly instruct examiners in how to formulate, evaluate, and present the determination of community development opportunity and need.
- <u>The institution's performance within the context of the bank's capacity.</u> However, the guidance does not clearly instruct examiners in how to illustrate and analyze the bank's level of performance in relation to the bank's financial ability.

In addition, the guidance does not clearly explain how examiners are to correlate the noted capacity, opportunity, and level of community development activity to the assigned rating and present that information in the PE report for the public's use. As part of the community development test, examiners are not required to but could consider and document within the PE report, the following information:

- the level of performance on an annual basis, when available;
- the complete listings and details of community development activities (or could adhere to a process that consistently summarizes and details community development activities); and
- a comparative analysis.

Conclusion

By enhancing examination guidance to ensure that PE reports include complete supporting information, public use and understanding of PE reports could be improved. While this information alone will not determine the bank's rating, the information is needed to help develop the analysis that supports the examiner conclusions in PE reports. From this foundation, the analysis performed could show consideration of the performance context, and the analysis could highlight other mitigating or critical factors that are being considered. The need for complete support is heightened by the fact that the PE reports are public documents that are used by individuals and community groups in understanding bank performance in the community. By ensuring complete information to support examination conclusions, the PE reports will become more informative and useful to the public. If the community development test incorporated similar analytical tools used for the lending test, such as totals, indices, and comparative measures, an independent reader could benefit from understanding the analysis performed and how the examiner's conclusions had been derived.

Recommendations

We recommend that the Director, DSC:

1. Enhance examiner guidance to ensure examiners provide complete support in the PE reports for their conclusions for the community development test, including:
   - The total number and dollar amount of community development loans, investments, and services, including providing totals on an annual basis, when available, and complete or consistent summary listings.
   - The determination of community development opportunity and need, including the consideration of the institution's own assessment, the examiner's analysis of economic and demographic data, the activities of similarly-situated institutions, community contact statements, and public comments.
   - The placement of community development activities into the context of the institution's capacity to meet those opportunities and needs, including the use and consideration of performance ratios where applicable.

2. Develop examiner guidelines that incorporate the use of comparative measures within the performance analysis, such as the use of annual level and trend performance ratios and customized peer group averages for the community development test.

MEASURING THE IMPACT OF THE 2005 AMENDMENTS

The FDIC has not established performance measures or a strategy to determine if the 2005 amendments to the CRA regulations have provided the intended regulatory relief for smaller community banks and preserved the importance of community development. Specifically, DSC has not developed, tracked, or analyzed information related to regulatory relief and the preservation of community development activities. While it may be premature to establish performance measures at this time, because the amendments are relatively new, the FDIC can develop a strategy to ensure that the necessary data collection resources and measures are in place to collect and analyze applicable CRA data. Such a strategy will position the FDIC to proactively assess the impact of the amendments made to the CRA regulations.

According to DSC, CRA performance has been measured to date by the community served and the information received through the process outlined in the Administrative Procedure Act (APA).[14]

[14] In accordance with the APA, federal regulatory agencies create the rules and regulations necessary to implement and enforce major legislative acts.

The APA process allows for the public to comment on the need for an amendment to the regulations. Those comments also serve as a measure of the success of a regulation and allow the federal banking agencies to assess the need for making necessary amendments.

In 1995, when the federal banking agencies and the Office of Thrift Supervision adopted major amendments to the regulations implementing CRA, the agencies committed to reviewing the amended regulations in 2002 for their effectiveness in emphasizing performance, promoting consistency in evaluations, and eliminating unnecessary burden.[15] In the case of the 2005 amendments to the CRA regulations, the federal banking agencies followed the APA process to satisfy the 1995 requirement to review the regulations. According to DSC, the FDIC relies on feedback received from interested parties such as consumer and community organizations, banks and bank trade associations, academics, federal and state government representatives, and individuals to determine the success of the CRA. The FDIC continuously measures the CRA regulations' effectiveness through the feedback they receive and will use the APA process again to assess the CRA regulations in conjunction with the next EGRPRA review. Further, DSC indicated that, although the FDIC considers these mechanisms sufficient for measuring CRA impact, a more comprehensive and quantifiable approach for measuring CRA impact would help the FDIC to ensure necessary data collection resources and measures are in place to analyze CRA data on a systemic and community-wide basis.

The EGRPRA requires the federal financial regulatory agencies to identify outdated, unnecessary, or unduly burdensome statutory or regulatory requirements. These agencies must then eliminate unnecessary regulations to the extent appropriate. Significant issues raised by the public and requiring legislative change must be referred to the Congress for appropriate action. The EGRPRA ensures attention is paid to the regulatory burden imposed on insured depository institutions and allows the financial industry and the public to have an opportunity to submit comments and recommendations for improvement. However, the EGRPRA review is on a 10-year cycle.

The FDIC has performed numerous CRA examinations of institutions' records in helping to meet the credit needs of their communities and can enhance mechanisms to gauge the impact of the amendments to the CRA regulations. Specifically, DSC has not developed, tracked, or analyzed information related to regulatory relief and the preservation of community development activities, which are the goals of the 2005 amendments to the CRA regulation. While the CRA requires each federal banking agency to assess each federally insured institution's record of helping to meet the credit needs of its entire community, the CRA and its implementing

[15] Generally, regulatory reviews to assess the need for regulatory amendments are made as a result of congressional requests, court proceedings, or as required by the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA), which requires the federal banking agencies to identify outdated, unnecessary, or unduly burdensome statutory or regulatory requirements. Not less frequently than once every 10 years, as required by the EGRPRA, the Federal Financial Institutions Examination Council (the Council) and each federal financial regulatory agency represented on the Council conduct a review of all regulations prescribed by the Council or by any such federal financial regulatory agency, to identify outdated or otherwise unnecessary regulatory requirements imposed on insured depository institutions.

regulations do not prescribe how the agencies should measure whether the CRA is meeting its intended purpose on a systemic and community-wide basis.

Neither the CRA nor the FDIC's policies and procedures require that the FDIC track or measure CRA performance. However, the Government Accountability Office (GAO) has issued *Standards for Internal Control in the Federal Government*[16] that include standards related to control activities and monitoring. Establishment and review of performance measures, including the comparison of performance to planned or expected results, are key components of control activities. Similarly, assessment of performance over time is a key component of monitoring. Control activities and monitoring also support a third internal control standard related to information and communications. This standard addresses the need for management to ensure there are adequate means of communicating information to external stakeholders that may have a significant impact on the agency achieving its goals. With regard to amendments to the CRA regulations, these external stakeholders include the public, Congress, community service organizations, and financial institutions. In the case of the CRA, measurements of impact are important because the regulations are performance-based rather than compliance-based.

Conclusion

Developing a strategy for measuring CRA impact would provide a meaningful assessment of the amendments made to the CRA regulations. Because the amendments are relatively new, it may be premature to establish outcome-oriented performance measures at this time. However, once the strategy has been in place for a period of time, the FDIC could develop outcome-oriented performance measures to assess CRA by comparing it to its intended purpose. Absent these measures, the FDIC is not well positioned to identify potential areas for improvement for institution implementation of the regulations or collect information to assess the results of the amendments to the regulations. Further, the public and stakeholders, such as the Congress, may not be informed as to the effectiveness of the CRA amendments and cannot take corrective action as necessary. Implementing a mechanism to measure CRA impact will improve FDIC management's oversight and reporting practices and will help to validate the success of achieving the intended results and goals of the regulatory amendments.

Recommendation

We recommend that the Director, DSC:

3. Develop a strategy for measuring CRA activities as a result of the amendments made to the regulations to assist the FDIC in determining if the amendments have provided regulatory relief for smaller community banks and preserved the importance of community development in the CRA examinations of these banks.

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[16] Internal control comprises the plans, methods, and procedures used by an organization to meet its missions, goals, and objectives, and in doing so, supports performance-based management.

CORPORATION COMMENTS AND OIG EVALUATION

On March 29, 2007, the Director, DSC, provided a written response to a draft of this report. DSC's response is presented in its entirety as Appendix VI to this report. Regarding recommendation 1, by December 31, 2007, DSC will issue guidance that requires examiners to present more complete information in support of their conclusions within the PE report. Further, by September 30, 2007, DSC will raise recommendations 2 and 3 for consideration by the other the federal banking agencies. Specifically, in relation to incorporating the use of comparative measures within the CRA performance analysis, among other factors, the agencies will assess whether appropriate information is reasonably available and whether incorporating such measures would improve the intermediate small bank CRA test. These measures include reducing the data collection burden on such banks and providing them with the flexibility to determine how they can best meet their community development responsibilities. Further, DSC stated that any CRA performance measures should be developed on an interagency basis.

DSC's actions are responsive to our recommendations. A summary of management's response to the recommendations is in Appendix VII. The recommendations are resolved but will remain open until we have determined the agreed-to corrective actions have been completed and are effective.

OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

The objectives of our audit were to determine whether the FDIC has (1) issued institution and examination guidance that addresses the 2005 amendments to the CRA regulations and (2) established outcome-oriented performance measures to determine if the revised regulations have provided the intended regulatory relief for smaller community banks and preserved the importance of community development. We conducted our audit in accordance with generally accepted government auditing standards during the period August 2006 through January 2007.

Scope and Methodology

The audit focused on ISBs and related DSC guidance provided to institutions and examiners and the measures in place to assess CRA impact. We performed the following:

- Obtained an understanding of the:
  - rationale for the amendments to the CRA regulations,
  - amendments to the CRA regulations, and
  - amendments to the CRA examination procedures and PE reports.
- Held an entrance conference and follow-up meetings with DSC and the FDIC's Legal Division.
- Gained an understanding of the amendments to the CRA regulations and their implementation through a review of the *Federal Register* and discussions with DSC, the Legal Division, and OIG Counsel and created a timeline to identify the development of the amendments and their intent.
- Reviewed and summarized laws, regulations, and other criteria pertaining to CRA, including:
  - FILs,
  - RD Memoranda, and
  - FFIEC guidance.
- Identified and discussed CRA-related issues with the FDIC's Office of the Ombudsmen.
- Identified CRA-related issues with the FDIC's Consumer Response Center - Kansas City.
- Identified and reviewed speeches given by the FDIC Chairman and other public information related to CRA.
- Created a cross-walk to ensure amendments to the regulations had been addressed in the revised institution and examination guidance.
- Compared large institution CRA examination procedures to the new ISB CRA examination procedures.
- Reviewed general information on the FDIC's *Consolidated Reports of Condition and Income* (Call Reports).

We selected a limited sample of PE reports prepared by FDIC examiners to gain an understanding of the manner in which the amended CRA regulations have been implemented. Specifically, we selected a non-statistical[17] sample of 10 CRA PE reports from a total of 263 PE reports for institutions that had been examined under either large or ISB examination procedures. The 10 reports were issued during the period September 2005 through August 2006 and consisted of 4 PE reports by the Chicago Region, 1 by the Atlanta Region, 1 by the Dallas Region, and 4 by the Kansas City Region. We selected our sample based on the following considerations:

- Banks with at least $250 million but less than $1 billion in total assets.
- Banks identified with a significant violation of the Equal Credit Opportunity Act and/or the Fair Housing Act, because the amended regulations clarified when discrimination and other illegal credit practices adversely affect CRA performance.
- Banks examined based on the ISB examination procedures.

We discussed our sample with DSC management to explain our methodology and to ensure that our sample would produce meaningful results. We also did the following:

- Reviewed and analyzed the PE reports to determine how the amended regulations were being implemented to achieve their intended purpose.
- Performed detailed analysis of the results of the community development test.

Internal Controls

We gained an understanding of relevant internal controls by reviewing: (1) DSC internal control and review reports; (2) FDIC policies and procedures, such as FIL and RD Memoranda, related to CRA; (3) the *Compliance Examination Handbook*; (4) examination procedures for assessing institution performance related to CRA; and (5) available FFIEC guidance regarding the implementation of CRA examination procedures. In addition, we held meetings with DSC individuals involved in establishing CRA policy and performed substantive testing on controls for integrating the revised regulations into FDIC policy. We also obtained an understanding of the process used to revise regulations. Finally, we reviewed the Office of Enterprise Risk Management *2006 Accountability Unit Listing* for DSC's Compliance and Consumer Protection Unit.

Reliance on Computer-Based Data

Our audit objective did not require that we separately assess the reliability of computer-processed data. We obtained certain data from DSC's System of Uniform Reporting of Compliance and CRA Performance Ratings application to identify CRA examinations conducted from September 2005 through August 2006. For purposes of the audit, we did not rely on computer-processed data to support our significant findings, conclusions, and recommendations. Our assessment centered on reviews of hardcopy reports of examination.

[17] The results of a non-statistical sample cannot be projected to the intended population by standard statistical methods.

Government Performance and Results Act

The Government Performance and Results Act of 1993 directs federal agencies to develop a strategic plan and annual performance plan to help improve federal program effectiveness and service delivery. We reviewed the FDIC's *Strategic Plan for 2005-2010* and the *FDIC 2006 Annual Performance Plan.* We determined that the FDIC has a strategic goal and objective related to the CRA performance of FDIC-supervised institutions but does not have outcome-oriented performance measures for the amendments made to the CRA regulations as discussed in this report. We reviewed the FDIC's *Corporate Performance Objectives* (CPO) for 2005 and 2006 and the proposed draft 2007 CPOs as of November 14, 2006. We determined that none of the 2006 CPOs directly relate to measuring CRA impact. We also reviewed DSC's *2006 Division Objectives* and determined that there were no actions directly related to measuring CRA impact.

Fraud and Illegal Acts

We did not develop specific audit procedures to detect fraud and illegal acts because they were not considered material to the audit objective. However, throughout the audit, we were sensitive to the potential for acts of fraud, waste, abuse, and mismanagement, and none came to our attention.

Laws and Regulations

In conducting the audit, we considered the following laws and regulations:

- **Housing and Community Development Act of 1977 (Public Law 95-128) – Title VIII (Community Reinvestment Act, 12 United States Code (U.S.C.) § 2901), 12 Code of Federal Regulations (C.F.R.) Part 345 of the FDIC Rules and Regulations.** The CRA requires each appropriate supervisory agency to assess an institution's record of helping to meet the credit needs of the local communities in which the institution is chartered, consistent with the safe and sound operation of the institution, and to take this record into account in the agency's evaluation of an application for a deposit facility by the institution. Part 345 establishes the framework and criteria the FDIC uses to assess a bank's record of helping to meet the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of the bank.

- **The Government Performance and Results Act of 1993 (GPRA).** The FDIC is subject to certain aspects of the GPRA. Under the GPRA, the FDIC is required to prepare and submit to the Office of Management and Budget a 5-year strategic plan and an annual performance plan. The FDIC is also required to file an annual report on program performance to the Congress.

- **Administrative Procedure Act (APA) (5 U.S.C. § 551 et seq.).** The APA requires about 55 federal regulatory agencies to follow a specific process to create the rules and regulations necessary to implement and enforce major legislative acts.

- **Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA).** Not less frequently than once every 10 years, the Federal Financial Institutions Examination Council and each federal banking agency represented on the Council shall conduct a review of all regulations prescribed by the Council or by any such appropriate federal banking agency, respectively, to identify outdated or otherwise unnecessary regulatory requirements imposed on insured depository institutions.

- **Equal Credit Opportunity Act (15 U.S.C. § 1691).** This act promotes the availability of credit to all creditworthy applicants without regard to race, color, religion, national origin, sex, marital status, or age. The regulation prohibits practices that discriminate on the basis of any of these factors.

- **Fair Housing Act (42 U.S.C. § 3601).** Subpart A of the Act prohibits all insured institutions, including insured state nonmember banks (ISNBs) supervised by the FDIC, from engaging in discriminatory advertising with regard to residential real-estate-related transactions. Subpart B notifies all ISNBs of their duty to collect and retain certain information about a home loan applicant's personal characteristics in accordance with Regulation B of the Federal Reserve (12 C.F.R. Part 1202) in order to monitor an institution's compliance with the ECOA.

Prior Audit Coverage

The OIG has conducted one prior audit related to CRA.

Audit Report No. 00-026, *Audit of the Division of Compliance and Consumer Affairs' Community Reinvestment Act Examination Process*, issued July 7, 2000. The objective of this audit was to determine (1) whether the Division of Compliance and Consumer Affairs[18] consistently applied CRA examination procedures within and among its regional offices and (2) whether these procedures were applied in a manner that ensured the resulting ratings provided an accurate measure of the banks' performance. We recommended that (1) to ensure the PE reports more fully support ratings given to institutions, the DCA Director should provide guidance to examiners that results in consistent examination procedures and reports in the areas related to: description of bank assets and selection of loan products for analysis; presentation of assessment area loan concentrations; and presentation of small business analyses; (2) to enhance support for CRA PE report conclusions through the use of examiner contacts with community organizations and leaders and the use of comparative analytical data, the DCA Director should (a) require examiners to include a separate section in the PE report to summarize the results of data obtained from community contacts; (b) revise the policy related to community contacts to eliminate certain qualifiers that allow examiners to avoid including information gathered from community contacts in PE reports; and (c) require that PE reports provide data on the scope of the small business/small farm lending reviews and the basis for the examiners' conclusions; and (3) to improve the supervisory review process, DCA should: (a) establish minimum guidelines for conducting quality assurance reviews

[18] The Division of Compliance and Consumer Affairs was subsequently merged into the division now referred to as DSC.

of PE reports; (b) require Field Office Supervisors and the Review Examiner to document their quality assurance reviews; and (c) establish a requirement for minimum working paper standards.

CRA PERFORMANCE EVALUATION RATING SYSTEM

The CRA requires the FDIC, in connection with the examination of a state nonmember insured financial institution, to assess the institution's CRA performance. A financial institution's performance is evaluated in the context of information about the institution (financial condition and business strategies), its community (demographic and economic data), and its competitors. Upon completion of a CRA examination, the FDIC rates the overall CRA performance of the financial institution using a four-tiered rating system.

In assigning a rating, the FDIC evaluates a bank's performance under the applicable performance criteria in the regulation, which provides for adjustments on the basis of evidence of discriminatory or other illegal credit practices. A bank's performance need not fit each aspect of a particular rating profile in order to receive that rating, and exceptionally strong performance with respect to some aspects may compensate for weak performance in others. The bank's overall performance, however, must be consistent with safe and sound banking practices and generally with the appropriate profile as follows.

Ratings Definitions

The following ratings are defined in the *Compliance Examination Handbook.*

"Outstanding." An institution in this group has an outstanding record of helping to meet the credit needs of its assessment area, including low- and moderate-income neighborhoods, in a manner consistent with its resources and capabilities.

"Satisfactory." An institution in this group has a satisfactory record of helping to meet the credit needs of its assessment area, including low- and moderate-income neighborhoods, in a manner consistent with its resources and capabilities.

"Needs to Improve." An institution in this group needs to improve its overall record of helping to meet the credit needs of its assessment area, including low- and moderate-income neighborhoods, in a manner consistent with its resources and capabilities.

"Substantial Noncompliance." An institution in this group has a substantially deficient record of helping to meet the credit needs of its assessment area, including low- and moderate-income neighborhoods, in a manner consistent with its resources and capabilities.

COMPARISON OF LARGE BANK CRA EXAMINATION PROCEDURES TO ISB EXAMINATION PROCEDURES

Large Bank	Intermediate Small Bank
Lending Test - The lending test is based on bank-collected loan data.	Lending Test - The lending test can be based on bank collected loan data, or if data are not collected, then examiner sampling.
Conclusions are based on: • lending activity; • geographic distribution; • borrower characteristics; • the number and amount of community development loans; and • use of innovative or flexible lending practices.	Conclusions are based on: • loan-to-deposit ratio analysis; • assessment area(s) concentration; • geographic distribution; • borrower characteristics; and • response to substantiated complaints.
Investment Test - The investment test is based on identified qualified investments.	Community Development Test - The community development test is based on the bank's responsiveness to community development needs through community development loans, qualified investments, and services – while also considering community need and bank capacity.
Conclusions are based on: • the number and dollar amount of qualified investments; • the innovativeness and complexity of qualified investments; • the degree to which these types of investments are not routinely provided by other private investors; and • the responsiveness of qualified investments to available opportunities.	Conclusions are based on: • the number and amount of community development loans; • the number and amount of qualified investments; • the extent to which the institution provides community development services, including the provision and availability of services to low- and moderate-income neighborhoods, including through branches and other facilities in low- and moderate-income areas; and • the responsiveness to the opportunities for community development lending, qualified investments, and community development services.

Large Bank	Intermediate Small Bank
Service Test - The service test is based on retail banking services and community development services.	
Conclusions are based on: • the distribution of branches among low-, moderate-, middle-, and upper-income geographies; • 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; • the availability and effectiveness of alternative systems for delivering retail banking services; • the extent to which the institution provides community development services; The innovativeness and responsiveness of community development services; and the range and accessibility of services provided in low-, moderate-, middle-, and upper-income geographies.	

Source: OIG analysis of FFIEC examination procedures and regulatory guidance.
Note: The Large Bank's highlighted sections signify areas that have been de-emphasized and/or have no corresponding area of consideration within the ISB examination procedures.

EXAMINATION AND INSTITUTION GUIDANCE

Financial Institution Letters	Description/Summary
• FIL-79-2005, *Community Reinvestment Act: Joint Final Rules*, dated August 9, 2005	The FDIC, FRB, and the OCC issued joint CRA rules, which became effective September 1, 2005. The interagency rules provide regulatory relief for smaller banks and preserve the importance of community development in the CRA evaluations of these banks.
• FIL-113-2005, *Community Reinvestment Act: Proposed Interagency Questions and Answers*, dated November 16, 2005	The FDIC, FRB, and OCC published proposed guidance on community reinvestment in the form of questions and answers (Q&A) (see FIL-23-2006 for adopted Q&As).
• FIL-23-2006, *Community Reinvestment Act: New Interagency Questions and Answers*, dated March 10, 2006	The FDIC, FRB, and the OCC published guidance on community reinvestment in the form of Q&As. The agencies have adopted all of the proposed Q&As or, as noted, with revision. The interagency Q&As were developed to address the amendments to the CRA regulations that took effect on September 1, 2005.
• FIL-33-2006, *Community Reinvestment Act: Interagency Examination Procedures*, dated April 10, 2006	The FDIC, FRB, and the OCC issued interagency CRA examination procedures for ISBs and revised procedures for small institutions, large institutions, wholesale and limited-purpose institutions, and institutions under a strategic plan. These examination procedures reflect the significant amendments to the CRA regulations that took effect on September 1, 2005.
DSC Regional Directors Memoranda	
• 06-009, *Revised Interagency CRA Examination Procedures*, dated April 3, 2006	Transmitted the revised interagency CRA examination procedures for small institutions, large institutions, wholesale and limited-purpose institutions, and institutions under a strategic plan.
• 05-046, *CRA Consideration of Activities that Revitalize or Stabilize Areas Affected by Hurricanes Katrina and Rita*, dated December 14, 2005	Distributed examiner guidance for the CRA consideration of activities that revitalize or stabilize designated disaster areas affected by Hurricanes Katrina and Rita and that benefit individuals displaced around the country.
• 05-032, *Interagency CRA Examination Procedures for Intermediate Small Institutions*, dated August 16, 2005	Distributed new interagency CRA examination procedures for ISBs.
DSC Compliance Examination Manual	The *DSC Compliance Examination Manual* was replaced by the *Compliance Examination Handbook* in June 2006. The *Compliance Examination Handbook* incorporated the new interagency CRA examination procedures for ISBs.

REVIEW OF DATA COLLECTION AND ANALYSIS FOR THE COMMUNITY DEVELOPMENT TEST

COMMUNITY DEVELOPMENT TEST	**Results of Sampled PE Reports**										
Bank Number Assigned by OIG for the Sample	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**Total**
Determination of Performance											
Community Development Loans											
Provided Description of Community Development Loans	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	10
Provided Complete Listing of Community Development Loans	✓	—	✓	✓	—	✓	✓	✓	✓	✓	8
Provided Number of Community Development Loans	✓	—	✓	✓	—	✓	✓	✓	✓	✓	8
Provided Dollar Amount of Community Development Loans	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	10
Provided Annual Breakdown of Number and Dollar Amounts	—	—	—	✓	—	—	—	✓	—	—	2
Community Development Investments											
Provided Description of Community Development Investments	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	10
Provided Complete Listing of Community Development Investments	✓	—	✓	—	—	—	✓	✓	—	✓	5
Provided Number of Community Development Investments	—	—	✓	—	—	✓	—	✓	—	✓	4
Provided Dollar Amount of Community Development Investments	—	✓	✓	✓	✓	✓	✓	✓	✓	✓	9
Provided Annual Breakdown of Number and Dollar Amounts	—	—	—	✓	—	—	—	—	—	—	1
Community Development Services											
Provided Description of Community Development Services	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	10
Provided Complete Listing of Community Development Services	✓	—	✓	—	—	✓	✓	✓	—	✓	6
Provided Number of Community Development Services	—	—	—	—	—	✓	—	—	—	—	1
Provided Annual Breakdown of Number	—	—	—	—	—	—	—	—	—	—	0
Determination of Opportunity for Community Development											
Provided Description of Assessment Area	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	10
Provided Description of Opportunity Based on the Bank's Assessment	—	✓	—	✓	—	—	—	—	—	—	2

COMMUNITY DEVELOPMENT TEST	**Results of Sampled PE Reports**										
Bank Number Assigned by OIG for the Sample	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**Total**
Provided Description of Opportunity Based on the Examiner's Economic and Demographic Assessment	—	—	✓	—	—	✓	—	—	✓	✓	4
Provided Description of Opportunity Based on the Activities of Similarly Situated Institutions (PE reports with identified similarly situated institutions)	—	—	—	—	—	✓	—	—	—	✓	2
Provided Description of Opportunity Based on the Statement of a Community Contact	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	10
Provided Description of Opportunity Based on Public Comments (Number of PE reports with identified public comments)	—	—	—	—	—	—	—	—	—	—	0
Provided Overall Conclusion on the Assessment Area's Opportunities	—	✓	✓	✓	✓	✓	—	✓	✓	✓	8
Provided Consideration of Opportunity Within a Statement of Conclusion	✓	✓	✓	—	✓	✓	✓	✓	✓	✓	9
Determination of Capacity for Community Development											
Provided a Description of the Institution	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	10
Provided a Description of Lending Performance to the Bank's Capacity	—	—	—	—	—	✓[a]	—	—	—	✓[a]	2
Provided a Description of Investment Performance to the Bank's Capacity	—	—	—	✓[b]	—	✓[b]	—	—	—	✓[b]	3
Provided an Overall Conclusion on the Institution's Capacity	—	✓	✓	✓	✓	✓	✓	✓	✓	✓	9
Provided Consideration of Capacity Within an Overall Statement of Conclusion	✓	✓	✓	—	✓	✓	✓	—	✓	✓	8

Source: OIG analysis of DSC's PE reports.

[a] The description of capacity was represented through the ratio of Community Development Loans to Net Loans.

[b] The description of capacity was represented through a ratio, such as, Community Development Investments to Total Investments or Community Development Investments to Total Assets.

Legend:

✓	PE report provided information as described.
—	PE report did not provide information as described.

CORPORATION COMMENTS

FDIC
Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990
Division of Supervision and Consumer Protection

DATE: March 29, 2007

TO: Russell A. Rau
Assistant Inspector General for Audits

FROM: Sandra L. Thompson
Director

SUBJECT: Response to OIG Draft Report Entitled: ***FDIC's Implementation of the 2005 Amendments to the Community Reinvestment Act Regulations (2006-025)***

This memorandum represents the Division of Supervision and Consumer Protection (DSC) response to the draft report entitled, *The FDIC's Implementation of the 2005 Amendments to the Community Reinvestment Act* (2006-025) ("Draft Report") prepared by the FDIC's Office of Inspector General (OIG). The objective of the audit was to determine whether the FDIC has (1) issued institution and examination guidance that addresses the 2005 amendments to the CRA regulations and (2) established outcome-oriented performance measures to determine if the amended regulations have provided the intended regulatory relief for smaller community banks and preserved the importance of community development.

The Draft Report recognizes that the FDIC has issued institution and examination guidance that addresses the 2005 amendments to the CRA regulations, including updated interagency CRA questions and answers in March 2006. The Draft Report also recognizes that examiners have generally followed the new examination procedures. DSC concurs with these findings.

OIG RECOMMENDATIONS AND DSC RESPONSES

1. **Enhance examiner guidance to ensure examiners provide complete support in the [Performance Evaluation]PE reports for their conclusions for the community development test, including:**

    - **The total number and dollar amount of community development loans, investments, and services, including providing totals on an annual basis, when available, and complete or consistent summary listings.**
    - **The determination of community development opportunity and need, including the consideration of the institution's own assessment, the examiner's analysis of economic and demographic data, the activities of similarly-situated institutions, community contact statements, and public comments.**

- **The placement of community development activities into the context of the institution's capacity to meet those opportunities and needs, including the use and consideration of performance ratios where applicable.**

DSC Response

DSC agrees with this recommendation. While current guidance already requires examiners to consider this information in the course of conducting a CRA evaluation, it does not require them to present their analysis in a PE report. By December 31, 2007, DSC will issue guidance that requires examiners to present more complete information in support of their conclusions within the PE report..

2. **Develop examiner guidelines that incorporate the use of comparative measures within the performance analysis, such as the use of annual level and trend performance ratios and customized peer group averages for the community development test.**

DSC Response

The current measures used in the intermediate small bank performance evaluation were jointly implemented by the FDIC, Office of the Comptroller of the Currency (OCC) and Federal Reserve Board of Governors (FRB).[1] These measures ensure that similar institutions are evaluated under comparable standards.

In addition, the Office of Thrift Supervision (OTS) has recently issued a proposal to realign its CRA rules with those of the other agencies.[2] In making this proposal, the OTS explained that, "a consistent CRA standard applied to the banking and thrift industries will facilitate objective evaluations of CRA performance; ensure accurate assessments of banks and thrifts that operate in the same market; and permit the public to make reasonable comparisons of bank and thrift CRA performance."[3]

In light of the importance the FDIC and the other federal banking agencies assign to consistent standards in this area, we will raise this recommendation for interagency consideration. Among other factors, the agencies will assess whether appropriate information is reasonably available, and whether incorporating such measures would improve the intermediate small bank CRA test. These include reducing the data collection burden on such banks, and to provide them with the flexibility to determine how they can best meet their community development responsibilities.

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1 Currently, Office of Thrift Supervision (OTS) CRA rules do not align with those of the other federal banking agencies. Among other things, these rules do not recognize "intermediate small banks". Consequently, the OTS has not issued procedures to examine such institutions.

2 See Notice of Proposed Rulemaking (NPR) titled, "Community Reinvestment Act – Interagency Uniformity", 71 Fed.Reg. 67826 (November 24, 2006).

3 See OTS NPR at p.67826.

DSC agrees to undertake these interagency discussions by September 30, 2007.

3. **Develop a strategy for measuring CRA activities as a result of the amendments made to the regulations to assist the FDIC in determining if the amendments have provided regulatory relief for smaller community banks and preserved the importance of community development in the CRA examinations of these banks.**

DSC Response

For the reasons discussed in our previous response, any performance measures in this area should be developed on an interagency basis. Consequently, as an alternative to unilateral consideration, we will also raise this recommendation with the other federal banking agencies, and do so by September 30, 2007.

MANAGEMENT RESPONSE TO RECOMMENDATIONS

This table presents the management response on the recommendations in our report and the status of the recommendations as of the date of report issuance.

Rec. No.	Corrective Action: Taken or Planned	Expected Completion Date	Monetary Benefits	Resolved:[a] Yes or No	Open or Closed[b]
1	DSC will issue guidance that requires examiners to present more complete information in support of their conclusions within the PE report.	December 31, 2007	$0	Yes	Open
2	DSC will raise this recommendation for consideration by the other federal banking agencies.	September 30, 2007	$0	Yes	Open
3	DSC will raise this recommendation for consideration by the other federal banking agencies.	September 30, 2007	$0	Yes	Open

[a] Resolved – (1) Management concurs with the recommendation, and the planned corrective action is consistent with the recommendation.
(2) Management does not concur with the recommendation, but planned alternative action is acceptable to the OIG.
(3) Management agrees to the OIG monetary benefits, or a different amount, or no ($0) amount. Monetary benefits are considered resolved as long as management provides an amount.

[b] Once the OIG determines that the agreed-upon corrective actions have been completed and are effective, the recommendation can be closed.