



Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

November 25, 1998

Interpretive Letter #849
December 1998
12 USC 2901

Dear []:

This letter responds to your request for an opinion regarding whether Funds Transfer Agent Agreements (FTAAs), developed by your bank, would receive favorable consideration as a community development (CD) service when the bank is evaluated for Community Reinvestment Act (CRA) performance. As discussed more fully below, providing FTAAs may receive favorable consideration as a CD service under the CRA regulations.

The Bank's Funds Transfer Agent Agreement Service

The Bank originally developed the FTAA to meet a financing need in the natural gas marketplace. The FTAA permits the Bank to act as a financial intermediary for small, women- and minority-owned natural gas marketers. The FTAA allows these companies to compete in the natural gas market when they would otherwise have difficulty in obtaining traditional financing.

Many new small businesses, including women- and minority-owned small businesses, grow so rapidly that their credit needs quickly outgrow their credit resources. This phenomenon is especially true for small businesses that market energy commodities, such as natural gas, because capital/credit requirements are large while profit margins are small. Generally, financial institutions require borrowers to meet equity-to-debt and minimum tangible net worth requirements before extending them credit. For instance, natural gas marketers are generally required to have between \$100,000 to \$500,000 in equity to execute a short-term natural gas contract with a commodity resale value of \$500,000 to \$1,000,000. Few small businesses have enough equity, or are able to support the issuance of a letter of credit, to satisfy the performance guarantee requirements of the contract.

A typical natural gas contract involving a marketing middleman (Marketer) has three main participants: the "Marketer," the gas "Supplier" and the end "Purchaser." Typically, the Supplier sells the gas to the Marketer, who resells it at a slight profit to the Purchaser.

Payment for the gas by the Purchaser occurs at a date subsequent to delivery. For example, the Purchaser might pay for all of the gas delivered in October at the end of November. Because the Supplier is not paid on delivery, the Marketer is usually required to provide a letter of credit to the Supplier during the time between delivery and final payment.

In [year], the [] State Assembly issued a directive requiring the state's utilities to increase substantially their purchases of goods and services from women- and minority-owned businesses. [] (), [State]'s largest natural gas utility, determined that credit was a major obstacle to []' ability to increase its purchases of natural gas from small businesses, including women- and minority-owned small businesses. The FTAA, an innovative financing vehicle, was developed to overcome this obstacle.

Unlike typical natural gas contracts, a natural gas contract that includes the FTAA involves a Marketer, a Supplier, a Purchaser and a Financial Institution. The Marketer signs a FTAA with the Financial Institution, which provides that the Financial Institution will act as the Marketer's Funds Transfer Agent (FTA). The Marketer incorporates the FTAA in the purchase contract with the Supplier and the sales contract with the Purchaser. The Financial Institution acts as an intermediary, handling payment from the Purchaser to the Supplier through a "blocked" account in the Marketer's name. (This does not constitute an extension of credit by the Financial Institution to the Marketer.) Title to the gas is instantaneously transferred from the Supplier to the Marketer to the Purchaser. Because the Financial Institution ensures that funds are directed to the proper parties, the Marketer is not required to provide a letter of credit or payment bond to the Supplier.

CRA Consideration of Funds Transfer Agent Agreement Service

The CRA regulations establish the framework and criteria by which the Agencies assess an institution's record of helping to meet the credit needs of the community. The regulations set out a number of different evaluation methods for examiners to use, depending on the business strategy and size of the institution under examination.

Many services that financial institutions offer to the public are considered during their CRA evaluations. In addition to retail banking services, examiners also consider community development services.¹

¹ Examiners evaluate large institutions' community development services under the service test. See 12 C.F.R. §§ 25.24(e), 228.24(e), 345.24(e), and 563e.24(e). Services that enhance credit availability in an institution's assessment area(s), including community development services, may be considered to determine if a small institution merits an outstanding CRA rating. See 12 C.F.R. pt. 25 app. A(d)(2), pt. 228 app. A(d)(2), pt. 345 app. A(d)(2), and pt. 563e app. A(d)(2). The community development test, which is appropriate for wholesale and limited purpose institutions, evaluates, *inter alia*, the number and amount of community development services. See 12 C.F.R. §§ 25.25(c)(1), 228.25(c)(1), 345.25(c)(1), and 563e.25(c)(1). And, finally, institutions evaluated on the basis of a strategic plan must include in their plan how they intend to meet the credit needs of their assessment area(s). They may meet credit needs through lending, investment, and/or services, as appropriate. See 12 C.F.R. §§

A “community development service” is a service that:

- (1) Has as its primary purpose community development;
- (2) Is related to the provision of financial services; and
- (3) Has not been considered in the evaluation of the institution’s retail banking services²

“Community development” is defined to include:

Activities that promote economic development by financing businesses or farms that meet the size eligibility standards of the Small Business Administration’s Development Company or Small Business Investment Company programs . . . or have gross annual revenues of \$1 million or less.³

Generally, a community development service will be considered, regardless of the performance test to which the financial institution is subject, if the service benefits the institution’s assessment area(s) or a broader statewide or regional area that includes the institution’s assessment area(s).⁴ In addition, examiners will consider limited purpose and wholesale institutions’ community development services nationwide if the institution has adequately met the needs of its assessment area(s).⁵

A “community development service” must (1) be related to the provision of financial services; (2) not be considered in the evaluation of the institution’s retail banking services; and (3) have a primary purpose of community development. The FTAA’s are a type of financial service, so providing FTAA’s clearly are related to the provision of financial services. In addition, FTAA’s are not the type of service that would generally be considered in the evaluation of the institution’s retail banking services. Thus, whether the FTAA’s are a community development service hinges on whether the FTAA’s have a primary purpose of community development.

FTAA’s may be “community development” services if they involve “financing [small] businesses or farms.” Financial institutions, in the FTAA arrangements, do not actually provide financing to businesses or farms. However, the FTAA arrangement alleviates the need for the small-business Marketer to obtain financing in the form of a letter of credit or

25.27(f)(1), 228.27(f)(1), 345.27(f)(1), and 563e.27(f)(1) (emphasis added).

² 12 C.F.R. §§ 25.12(j), 228.12(j), 345.12(j) and 563e.12(i).

³ 12 C.F.R. §§ 25.12(h)(3), 228.12(h)(3), 345.12(h)(3), and 563e.12(g)(3).

⁴ See 12 C.F.R. §§ 25.24(b), 25.25(e)(1), 25.27(f)(1)(i), 228.24(b), 228.25(e)(1), 228.27(f)(1)(i), 345.24(b), 345.25(e)(1), 345.27(f)(1)(i), 563e.24(b), 563e.25(e)(1), and 563e.27(f)(1)(i). See also 12 C.F.R. pt. 25 app. A(d)(2), pt. 228 app. A(d)(2), pt. 345 app. A(d)(2), and pt. 563e app. A(d)(2).

⁵ 12 C.F.R. § 25.25(e)(2), 228.25(e)(2), 345.25(e)(2), and 563e.25(e)(2).

payment bond, which would likely be unavailable to the small business because of its lack of equity. Thus, the FTAA arrangement is a financial service that substitutes for direct financing, and, as a credit substitute, it may help to “meet the credit needs” of the community.

Financing small businesses and farms is “community development”⁶ if the activity meets both a size test and a purpose test.⁷ The size test is met if the marketing businesses on whose behalf the institution acts as agent in the FTAA meet the size eligibility standards in the regulations. Your letter indicates that small businesses assisted by the FTAA meet the size eligibility standards of 13 C.F.R. § 121.301 for both the Small Business Administration’s Development Company or Small Business Investment Company programs: “the applicants, including their affiliates, have tangible net worth not in excess of \$6 million and average net income after Federal income taxes (excluding any carryover losses) for the preceding two completed fiscal years of less than \$2 million.” The purpose test is met if the activity promotes economic development. Agency staff have determined that an activity promotes economic development “if it supports permanent job creation, retention, and/or improvement for persons who are currently low- or moderate-income, or supports permanent job creation, retention, and/or improvement in low- or moderate-income geographies, or in areas targeted for redevelopment by Federal, state, local or tribal governments.”⁸ Therefore, a financial institution that acts as an intermediary pursuant to a FTAA may receive favorable consideration for providing a community development service *as long as* the FTAA promotes economic development by providing financial services that enable small-business marketers to grow, thus necessitating, for example, the hiring of additional employees, including low- and moderate-income individuals.

I trust this letter is responsive to your request. If you have further questions, please contact me or Margaret Hesse, an attorney on my staff, at (202) 874-5750.

Sincerely,

/s/

Michael S. Bylsma
Director
Community and Consumer Law Division
Office of the Comptroller of the Currency

⁶ 12 C.F.R. §§ 25.12(h)(3), 228.12(h)(3), 345.12(h)(3), and 563e.12(g)(3).

⁷ See Community Reinvestment Act; Interagency Questions and Answers Regarding Community Reinvestment, 62 Fed. Reg. 52,105, 52,111 (Oct. 6, 1997) (Question and Answer 1 regarding Sections __.12(h)(3) and 563e.12(g)(3)).

⁸ *Id.*

