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Comptroller of the Currency  
Administrator of National Banks

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Washington, DC 20219

*Interpretive Letter #673*  
*July 1995*  
*12 U.S.C. 2901*

June 26, 1995

[ ]

Dear [ ]:

This letter responds to your inquiry regarding the application of the Community Reinvestment Act (CRA) to investments by national banks in a nationally chartered bank with a community development focus.

The regulation governing the CRA, 12 CFR Part 25, was revised substantially in May, 1995. See 60 Fed. Reg. 22156 (May 4, 1995). There are a number of phase-in dates for the regulatory provisions, depending on the size of the institution and the regulatory requirement. See 12 CFR § 25.51, 60 Fed. Reg. 22186. Due to the phase-in period, this letter addresses the implications of both the old and new CRA rules.

As described in more detail below, lawful investments by national banks in a nationally chartered bank with a community development focus would generally receive favorable consideration under both the old and the new regulations.

#### I. Proposal

Under your proposal, national banks will invest start-up capital in a national bank with a community development focus (CDB). The CDB, which will meet the requirements for investments that primarily promote the public welfare set out in 12 CFR Part 24, will serve residents and businesses of a city's underserved low- and moderate-income neighborhoods by providing targeted credit products, depository services, and outreach programs. The national banks' investments will be made through the purchase of shares in the CDB and will not be guaranteed.<sup>1</sup>

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<sup>1</sup> The authority for national banks to make investments in community development banks and other community development financial institutions that primarily promote the public

It is anticipated that the CDB's loan activity will start out at a relatively low level and will increase significantly each year over the first five years of operation, as demand for loans and the CDB's deposit base increase. During the initial years, when the loan-to-asset ratio is low, a large proportion of assets is expected to be invested in securities.

## II. Old Rule

The old rule lists twelve assessment factors that are used in assessing CRA performance. At least two of these factors provide a basis for examiners to give consideration to a national bank's investment in the CDB if it serves the bank's delineated community. First, 12 CFR § 25.7(h) provides that the OCC will consider a bank's "participation, including investments, in local community development and redevelopment projects or programs." An investment in the CDB would be considered a community development project. Second, 12 CFR § 25.7(l) allows the OCC to consider other factors that reasonably bear upon the extent to which a national bank is helping to meet the credit needs of its entire community. Under this authority, OCC examiners would consider favorably investments in a CDB, which would target communities in the investing bank's delineated community that have underserved credit needs.<sup>2</sup>

## III. New Rule

The new CRA rule provides a more detailed framework for assessment of a bank's CRA performance. The new rule sets out a number of different tests for examiners to use, depending on the type of activity and the size and type of institution. You have inquired specifically about the application of the lending, investment and service performance tests. Under the new rule, these performance tests generally will be used to evaluate large, retail institutions, those with assets of more than \$250 million or in holding companies with bank and thrift assets of more than \$1 billion. The overall CRA rating for a large, retail institution is based on ratings on each of these tests. These tests are not applied to small institutions, wholesale or limited purpose institutions or to institutions which opt to comply with CRA by

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welfare is found in 12 CFR Part 24, which implements 12 U.S.C. § 24(Eleventh). Under Part 24, these investments are included within the definition of community development projects. See 12 CFR § 24.2(e).

<sup>2</sup> For additional guidance on the application of the old CRA rule, see OCC Banking Bulletin 93-11, published March 5, 1993, which provides interagency questions and answers regarding CRA. Question 18 explains that equity investments in public purpose corporations that are chartered to carry out activities to benefit low- and moderate-income areas and residents or small businesses would receive consideration under the old CRA rule. Question 17 clarifies that activities in addition to lending are considered in the CRA evaluation, noting that "the agencies will consider the institution's ... involvement through investment or other contributions in a local community development project."

developing a strategic plan. However, the performance of these institutions in providing lending, investment and services will also be considered in determining their CRA ratings.

Although the new rule identifies a variety of specific tests and objective measurement tools, evaluation of a bank's performance still depends significantly on examiner judgment. The fundamental determination that an examiner must make in regard to an investment is the extent to which it contributes to a bank's overall record of helping to meet credit needs in its assessment area. That determination will not depend materially on whether the investment is evaluated under the lending test, the investment test, or both.

In evaluating a national bank's CRA performance under the new rule, the OCC will look for measurable evidence that an institution is working to help meet the credit needs of its entire community. An investment in an entity that is targeted to serve some of the most pressing credit and community development needs in the bank's community will certainly be considered favorably in CRA examinations.

Detailed guidance is provided below on each of your four questions relating to how community development investments will be evaluated under the lending, investment and service tests.

**A. Whether a national bank may choose to receive "credit" under the lending, the investment, and the service tests of the CRA.**

As described more fully below, a national bank can choose to have its investment in the CDB evaluated entirely under the investment test, entirely under the lending test or under both, with a portion of the investment allocated to each test. The service test, however, evaluates services that national banks provide directly, not monetary investments.

The lending test evaluates a bank's lending activities by considering a bank's purchase or origination of home mortgage, small business, small farm, community development, and, in some instances, consumer loans. Among the performance criteria considered in the lending test is a bank's community development lending, including the number and amount of community development loans and their complexity and innovativeness. See 12 CFR § 25.22(b)(4), 60 Fed. Reg. 22181. A "community development loan" must have community development as its primary purpose.<sup>3</sup> In addition, to be considered under the lending test, community development

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<sup>3</sup> Community development is defined in the new rule to include: (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. See 12 CFR § 25.12(h), 60 Fed. Reg. 22179.

loans must benefit an area that includes the bank's assessment area. See 12 CFR § 25.12, 60 Fed. Reg. 22179. The new rule allows a bank that invests in a community development financial institution (CDFI) or other entity that uses a bank's investment to make loans, such as the CDB, to receive consideration under the lending test for its pro-rata share of community development loans made by the CDFI or other entity.

The investment test evaluates a bank's number and amount of qualified investments, the innovativeness or complexity of its qualified investments, the responsiveness of the qualified investments to credit and community development needs, and the degree to which the qualified investments are not routinely provided by private investors. See 12 CFR § 25.23(e), 60 Fed. Reg. 22181. Qualified investments include lawful investments, deposits, membership shares or grants that have as their primary purpose community development. 12 CFR 25.12(s), 60 Fed. Reg. 22180. To be considered under the investment test, qualified investments must benefit an area that includes the bank's assessment area. See 12 CFR § 25.23(a), 60 Fed. Reg. 22181. Qualified investments include, but are not limited to, investments in CDFIs that primarily lend in low- and moderate-income areas or to low- and moderate-income individuals to promote community development and investments in state and municipal obligations that specifically support community development. See 60 Fed. Reg. 22162 n.3.

The service test evaluates both the availability and effectiveness of a bank's systems for delivering retail banking services and the extent and innovativeness of its community development services. A "community development service" has as its primary purpose community development and is related to the provision of financial services. 12 CFR § 25.12(j), 60 Fed. Reg. 22179. Examples of community development services include, among other things, providing technical expertise for not-for-profit organizations serving low- or moderate-income housing needs and providing credit counseling. See 60 Fed. Reg. 22160 n. 2. However, community development services do not include monetary investments in third parties that perform banking services, such as the CDB.<sup>4</sup> Of course, the CDB will receive consideration in its own CRA evaluation for the services that it provides with the capital it raises from investors. Similarly, an investing bank will receive consideration for services that it provides directly. These services could include services that it donates to a third party to promote community development, such as an executive loaned to the CDB. 60 Fed. Reg. 22160 & n.2.

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<sup>4</sup> The rule explicitly provides that a bank can receive consideration under the lending test for lending by a consortium or third party in which the bank participates or invests. See 12 CFR § 25.22(d), 60 Fed. Reg. 22181. The rule does not similarly provide that a bank can receive credit for services by a third party. See 12 CFR § 25.24, 60 Fed. Reg. 22181-82. The preamble to the final rule states that investments in third party community development organizations may be treated as either qualified investments or as community development loans. There is no mention of giving consideration for services that might be provided by the third party institution. See 60 Fed. Reg. 22166-67.

**B. Whether a national bank investor may receive "credit" for a pro-rata share of the community development loans made by a community development bank under the lending test and claim the balance of the investment under the investment test.**

As noted above, a bank can choose to have a portion of its investment evaluated under the lending test and a portion evaluated under the investment test. However, in so doing, the bank must provide the OCC with the necessary information to calculate the appropriate breakdown.

Under the investment test, a bank receives consideration only for its own investment and not for investments made by a third party in which it has invested. Therefore, a bank can receive consideration only up to the actual amount of money it has invested. For example, assume a bank invests \$1 million in the CDB, which has a total capitalization of \$10 million, and the CDB holds \$15 million in qualified investments. The maximum amount of qualified investment that would be considered in the evaluation of the investing bank would be \$1 million.

If the investing bank opts to have a portion of its investment evaluated under the lending test by claiming a share of the CDB's loans as community development loans, the amount of investment considered under the investment test would be offset by that portion. The amount of the offset would be determined by the percentage of assets of the CDB that are attributable to loans as compared to other assets. For example, if loans comprised 40% of the CDB's assets, and the investing bank requested consideration of its pro-rata share of these loans in its lending test evaluation, the bank could receive consideration for only 60% (\$600,000) of its investment in the CDB in its investment test evaluation. In addition, to receive favorable consideration, the bank would have to provide information indicating that the non-loan assets of the CDB are composed substantially of qualified investments.

Under the lending test, the investing bank would receive consideration for its pro rata share of loans made by the CDB that qualify as community development loans. If the CDB had originated and purchased \$8 million of these loans, the investing bank would receive consideration for \$800,000, because it contributed 10% of the capital of the CDB.

**C. Whether in determining the pro rata share of community development loans, it is appropriate to consider originations and purchases, as well as other data that the OCC may consider under the lending test.**

The OCC considers originations and purchases when determining the investing bank's pro-rata share of loans. See 12 CFR § 25.22(a)(2), 60 Fed. Reg. 22180. The OCC will also consider any lending data that the investing bank wishes to provide which can provide insight into the impact of the investment on the CDB's community development lending. In contrast, under the investment test, the OCC considers outstanding investments. Thus, an investing bank receives consideration for an investment for each examination period in which an investment is made or held.

**D. Whether a national bank investor would receive enhanced "credit" for its investment in a community development bank.**

As noted above, a bank's qualified investments are evaluated under the investment test based on factors including the innovativeness and complexity of the investment, the responsiveness to community credit needs, and the degree to which the investment is not routinely provided. See 12 CFR § 25.23(e), 60 Fed. Reg. 22181.

A newly formed CDFI could be deemed innovative and complex, depending on the mission and capacity of the particular CDFI. An insured CDFI, like the CDB, would generally be more complex than an uninsured CDFI, like a consortium or loan fund. If a CDFI were formed in an area where there were few other active institutions, or provided loans, investments and services that were lacking, an investing bank could receive consideration for the fact that its investment has not been routinely provided by other investors. The case for favorable consideration under these factors would be especially strong for start-up investors who commit to provide a firm source of capital, as opposed to depositors or grant providers. Similarly, a CDFI could provide an effective vehicle for a bank investor to demonstrate responsiveness to credit and community development needs. However, the OCC cannot conclude that a proposed CDFI will actually fulfill these conditions until after the CDFI is operating and has demonstrated its performance. Examiners will consider any information that an investing bank provides to demonstrate the uniqueness, complexity, and responsiveness of the activities of a CDFI in which the bank has invested.

As discussed above, investing banks can receive consideration under the lending test of their pro-rata share of community development loans originated or purchased by the CDFI. Those loans will be evaluated to determine whether they are particularly complex or innovative. See 12 CFR § 25.22(b)(4), 60 Fed. Reg. 22181. Examiners will reflect that determination in their judgment about the investing bank's community development lending performance.

I trust this letter has been responsive to your inquiry. If you need additional guidance on these issues, please feel free to contact me or Anne Hoskins, an attorney on my staff.

Sincerely,

/s/

Matthew Roberts  
Director  
Community and Consumer Law