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

Interpretive Letter #702
February 1996
12 U.S.C. 2901

February 13, 1996

[ ]

Dear [ ]:

This responds to your letter of October 31, 1995, to Janice Booker, Director of the Office of the Comptroller of the Currency's Community Development Division, in which you outlined your understanding of the regulatory treatment permitted under the Community Reinvestment Act (CRA) for an investment in a proprietary Unit Investment Trust (UIT). Prior to this letter, National Bank Examiner Malloy Harris provided oral guidance regarding your proposal; however, you subsequently requested a formal response. As you know, the four bank and thrift agencies have promulgated substantively identical CRA regulations. Therefore, staff from all of the agencies have considered the issues you raised, and they concur in the opinions expressed in this letter.

As we understand the proposal, the UIT would hold either FNMA or GNMA mortgage-backed securities that are collateralized by one-to-four family mortgage loans. The underlying mortgage loans will be originated by minority- and women-owned financial institutions and extended to individuals earning 50 to 100 percent of area median income. A financial intermediary will then purchase the loans and issue the mortgage-backed securities that will be held by the UIT. Your letter asked two questions: (1) What consideration under the CRA regulations will be afforded financial institutions originating loans for the UIT?; and (2) What consideration under the CRA regulations will be afforded institutions that invest in the UIT? As discussed below, depending on various factors, both the institutions that originate the loans and the institutions that invest in the UIT may receive positive consideration under the CRA regulations.[*]

[*] This letter discusses only whether participation in the UIT by federally regulated financial institutions would receive favorable consideration under the CRA regulations. The federal financial institutions regulatory agencies do not endorse particular investment opportunities offered to financial institutions.

Discussion

As you may be aware, the CRA was designed to encourage institutions to help meet the credit needs of their entire communities, including low- and moderate-income areas, consistent with safe and sound lending practices. The banking and thrift regulatory agencies published amended CRA regulations on May 4, 1995, at 60 Fed. Reg. 22,156. The new regulations set out a number of different tests for examiners to use in evaluating CRA performance, depending on the type of activity and the size and type of institution. Your letter focuses on whether institutions' activities in connection with the UIT will receive positive consideration under the lending and investment tests. Our response, therefore, addresses consideration under the lending and investment tests, which are applicable primarily to large institutions.

Institutions originating the loans

Under the lending test, the agencies evaluate institutions' originations and purchases of home mortgage loans, as well as other types of loans. *See* 60 Fed. Reg. at 22,180, 22,192, 22,203, and 22,214 (to be codified at 12 C.F.R. §§ 25.22(a)(1) & (2), 228.22(a)(1) & (2), 345.22(a)(1) & (2), and 563e.22(a)(1) & (2)). Examiners consider the number and amount of home mortgage loans in the institution's assessment area(s); the geographic distribution of the institution's home mortgage loans, based on the loan location, including the proportion of lending in the institution's assessment area(s), the dispersion of lending in the assessment area(s), and the number and amount of loans in low-, moderate-, middle-, and upper-income geographies in the institution's assessment area(s); the distribution, particularly in the institution's assessment area(s) of the institution's home mortgage loans based on borrower characteristics, including the number and amount of home mortgage loans to low-, moderate-, middle-, and upper-income individuals; and the institution's use of innovative or flexible lending practices in a safe and sound manner to address the credit needs of low- or moderate-income individuals or geographies. *See* 60 Fed. Reg. at 22,181, 22,192, 22,203, and 22,214 (to be codified at 12 C.F.R. §§ 25.22(b), 228.22(b), 345.22(b), and 563e.22(b)). Therefore, under the lending test, examiners will consider all home mortgage loans originated by institutions.

Examiners also consider an institution's community development lending under the lending test. A "community development loan" is a loan that:

> (1) Has as its primary purpose community development; and
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> (2) Except in the case of a wholesale or limited purpose bank:
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> (i) Has not been reported or collected by the bank or an affiliate for consideration in the bank's assessment as a home mortgage . . . loan, unless it is a multifamily dwelling loan . . .; and

(ii) Benefits the bank's assessment area(s) or a broader statewide or regional area that includes the bank's assessment area(s).

60 Fed. Reg. at 22,179 (to be codified at 12 C.F.R. § 25.12(i)). *See also* 60 Fed. Reg. at 22,190, 22,202, and 22,213 (to be codified at 12 C.F.R. §§ 228.12(i), 345.12(i), and 563e.12(h)). "Community development" means, *inter alia*, "affordable housing (including multifamily rental housing) for low- or moderate-income individuals." 60 Fed. Reg. at 22,179, 22,190, 22,202, and 22,212 (to be codified at 12 C.F.R. §§ 25.12(h)(1), 228.12(h)(1), 345.12(h)(1), and 563e.12(g)(1)). Therefore, under the lending test, some housing loans may qualify as community development loans. Under this provision, they would so qualify if the loans had not been reported and collected by the institution (or an affiliate) as home mortgage loans (unless they were multifamily dwelling loans) and they provide affordable housing for low- or moderate-income individuals in the institution's assessment area(s) or a broader statewide or regional area that includes the institution's assessment area(s).

In your proposal, you stated that the one- to four-family mortgage loans would be extended to individuals earning 50 to 100 percent of area median income. You should be aware that, under the CRA regulations, low-income is defined as less than 50 percent of median income and moderate-income is defined as at least 50 percent and less than 80 percent of median income.

Institutions that invest in the UIT

An institution that invests in the UIT may receive positive CRA consideration under the investment test, assuming the investment meets the definition of "qualified investment." The regulations define a "qualified investment" as a "lawful investment . . . that has as its primary purpose community development." *See* 60 Fed. Reg. at 22,180, 22,191, 22,202, and 22,213 (to be codified at 12 C.F.R. §§ 25.12(s), 228.12(s), 345.12(s), and 563e.12(r)). The phrase "primary purpose" is not defined in the regulations; however, it would commonly be understood to mean that the main purpose of the investment activity is community development. As discussed above, "community development" means, *inter alia*, affordable housing (including multifamily rental housing) for low- or moderate-income individuals. An investment in a UIT composed primarily of mortgage-backed securities based on loans that were extended to individuals earning below 80 percent of median income would fall within this criterion.

Assuming an institution's investment in the UIT is a qualified investment and that the investment benefits the institution's assessment area(s) or a broader statewide or regional area that includes its assessment area(s), examiners will consider this investment along with all of the institution's qualified investments under the investment test. Examiners will evaluate the investment performance of the institution pursuant to the following criteria:

(1) The dollar amount of qualified investments;

(2) The innovativeness or complexity of qualified investments;

(3) The responsiveness of qualified investments to credit and community development needs; and

(4) The degree to which the qualified investments are not routinely provided by private investors.

60 Fed. Reg. at 22,181, 22,192, 22,204, and 22,215 (to be codified at 12 C.F.R. §§ 25.23(e), 228.23(e), 345.23(e), and 563e.23(e)).

I trust this information is helpful to you. You may also be interested to know that the staffs of the four financial supervisory agencies are presently developing an official commentary to provide additional guidance for resolving interpretive questions arising under the new CRA regulations. In the meantime, if you have further questions, please contact me or Margaret Hesse, an attorney on my staff, at (202) 874-5750.

Sincerely,

/s/

Matthew Roberts
Director
Community and Consumer Law
Office of the Comptroller of the Currency