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

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**Interpretive Letter #726  
July 1996  
12 U.S.C. 2901**

June 28, 1996

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Dear [ ] and [ ]:

This responds to your inquiry regarding the application of the Community Reinvestment Act (CRA) regulations to a financial institution's support of [Company]'s small business lending programs. As you probably know, the four federal financial supervisory agencies finalized new CRA regulations on May 4, 1995. See 60 Fed. Reg. 22,156 (May 4, 1995) (to be codified at 12 C.F.R. parts 25, 228, 345 and 563e). The agencies' regulations are substantively identical. Therefore, staff from all of the agencies have considered the issues you raised, and they concur in the opinions expressed in this letter.

**I. BACKGROUND**

As your letter explains, [Company] provides access to credit and technical assistance for very small businesses (microenterprises)<sup>1</sup> in Latin America and the United States. Typically, microenterprises have difficulty obtaining credit because they lack collateral and the loans they require are often too small to be cost effective for most financial institutions. In the United

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<sup>1</sup> [Company] defines "microenterprise" as an informal business with ten or fewer employees and in which the owner actively participates. Financing microenterprises generally promotes economic development because microenterprises are typically located in low- or moderate-income areas and include street vendors, seamstresses, artisans, small shops and restaurants, shoemakers and carpenters. Microentrepreneurs and their employees are also frequently low- or moderate-income earners.

States, the [Affiliate] acts as an intermediary between microenterprises and financial institutions to address these problems.

The [Affiliate] issues private placements of promissory notes with various investors. With the money it receives from these investors, the [Affiliate] issues letters of credit to financial institutions. The letters of credit guarantee a portion of each loan made by the financial institutions to [Affiliate 2]. The [Affiliate 2] use the loans from the financial institutions to fund their microenterprise lending (microlending) programs in New York, New Mexico, Illinois, Texas, and California. This system allows financial institutions to participate in microlending without bearing the risk of undersecured loans or incurring the costs of making those loans directly.

## **II. DISCUSSION**

Based on the microlending program described above, you have asked whether: 1) a financial institution's purchase of a promissory note that funds guarantees of loans to microenterprise lenders would be a qualified investment under CRA; 2) a financial institution would receive favorable CRA consideration for a loan to a microenterprise lender; and 3) a financial institution's loan to a guarantor, such as the [Affiliate], or microenterprise lender would qualify under the CRA investment test if the loan had a 10-to-20 year term, low interest rate, and deep subordination.

In addition, you have asked whether a financial institution would receive positive CRA consideration for the following proposed activities: 1) investing funds in a pool that would be managed by a microenterprise lender and used for microlending; or 2) purchasing a microloan portfolio from a guarantor or purchasing a security backed by such a portfolio.

Finally, you have asked whether the CRA regulations would place geographic restrictions on a financial institution's support of either the existing program or the proposed activities.

### **A. Questions Based on [Company]'s existing microlending program**

#### **1. Purchases of Promissory Notes**

A financial institution's purchase of a promissory note that funds guarantees of loans to local intermediaries that lend to microenterprises to promote economic development would be considered a qualified investment under the CRA regulations unless the purchase is carried on the institution's books as a loan.<sup>2</sup> The new CRA regulations provide a detailed framework for

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<sup>2</sup> If the purchase is carried on the institution's books as a loan, it would qualify as a community development loan for the reasons discussed below in the section concerning loans to microenterprise lenders.

evaluating an institution's CRA performance. The new rules set out a number of different evaluation methods for examiners to use, depending on the business strategy and size of the institution under examination.

Regardless of the evaluation methods used by examiners, however, any financial institution can receive positive consideration for making a "qualified investment" that benefits its assessment area or a broader statewide or regional area that includes the assessment area.<sup>3</sup> The new CRA regulations define "qualified investment" as "a lawful investment, deposit, membership share or grant that has as its primary purpose community development." See 12 CFR §§ 25.12(s), 228.12(s), 345.12(s), and 563e.12(r). "Community development" is defined to include, among other things, "activities that promote economic development by financing [small] businesses. . . ." See 12 CFR §§ 25.12(h)(3), 228.12(h)(3), 345.12(h)(3), and 563e.12(g)(3).

A purchase of a promissory note that provides credit enhancement on loans to microenterprise lenders to promote economic development has as its primary purpose community development because the note enables microenterprise lenders to provide loans to small businesses that are located in low- or moderate-income areas or that provide jobs for low- or moderate-income persons. Assuming that the microenterprise lenders serve a regional area that includes a financial institution's assessment area, examiners would give positive consideration to a financial institution's purchase of promissory notes as a qualified investment under any of the new performance tests and standards in the new CRA regulations.

## **2. Loans to Microenterprise Lenders**

If a financial institution makes a loan directly to a microenterprise lender to support the lender's financing of small businesses to promote economic development, its loan would be a community development loan under the CRA regulations. See 12 CFR §§ 25.12(i), 228.12(i), 345.12(i),

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<sup>3</sup> Examiners of large institutions, which are evaluated under the lending, investment and service tests, consider qualified investments under the investment test. See 12 CFR §§ 25.23(a), 228.23(a), 345.23(a), and 563e.23(a). In a small institution examination, examiners may adjust an institution's loan-to-deposit ratio, if appropriate, based on lending-related qualified investments. See 12 CFR §§ 25.26(a)(1), 228.26(a)(1), 345.26(a)(1), and 563e.26(a)(1). Qualified investments may also be considered to determine if a small institution merits an outstanding CRA rating. See 12 CFR 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 qualified investments. See 12 CFR §§ 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 CFR §§ 25.27(f)(1), 228.27(f)(1), and 563e.27(f)(1) (emphasis added).

and 563.12(h). A “community development loan” is a loan that has community development as its primary purpose and, except in the case of a wholesale or limited purpose bank, benefits the institution’s assessment area(s) and has not been considered as part of the institution’s assessment as a home mortgage, small business, small farm, or consumer loan. 12 CFR §§ 25.12(i), 228.12(i), 345.12(i), and 563e.12(h).

A large retail institution’s record of helping to meet community credit needs through its lending activities is evaluated under the lending test. See 12 CFR § 25.22, 248.22, 345.22, and 563e.22. Under the lending test, examiners consider an institution’s originations and purchases of loans, including community development loans. See 12 CFR § 25.22(a)-(c), 228.22(a)-(c), 345.22(a)-(c), and 563e.22(a)-(c). Community development loans may also be considered favorably in the evaluations of small institutions, wholesale and limited purpose institutions, and institutions evaluated based on a strategic plan. See 12 CFR §§ 25.25(c), 25.26(a)(1), 25.27(f)(1), g(3)(i), and pt. 25 app. A(d)(2); §§ 228.25(c), 228.26(a)(1), 228.27(f)(1), g(3)(i), and pt. 228 app. A(d)(2); §§ 345.25(c), 345.26(a)(1), 345.27(f)(1), g(3)(i), and pt. 345 app. A(d)(2); and §§ 563e.25(c), 563e.26(a)(1), 563e.27(f)(1), g(3)(i), and pt. 563e app. A(d)(2). Thus, examiners would favorably consider as a community development loan a financial institution’s loan to a microenterprise lender.<sup>4</sup>

### **3. Loans to a Microenterprise Lender or Guarantor on Favorable Terms**

You have also asked whether a financial institution could receive consideration under the investment test for a loan to a microenterprise lender or guarantor that had a 10-to-20 year term, low interest rate, and deep subordination to other lenders. As discussed above, the investment test considers qualified investments, which are defined as lawful investments, deposits, membership shares, or grants that have as their primary purpose community development. As a general rule, the agencies would not view as a qualified investment a transaction that is carried on a financial institution’s books as a loan.

## **B. Questions Related to [Company]’s Proposed Activities**

### **1. Investments in a Microloan Pool Managed by a Microenterprise Lender**

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<sup>4</sup> In your letter, you also ask whether a financial institution’s investment in the [Affiliate]’s loan loss reserve would receive favorable CRA consideration. The staff of the federal financial supervisory agencies concluded recently that a financial institution would receive positive CRA consideration for its investments in, or loans to, a reserve fund for affordable housing loans. See interagency letter published as OCC Interpretive Letter No. 708 (February 16, 1996) (attached). Investments in a reserve fund for small business loans would receive comparable consideration.

A financial institution would also receive favorable CRA consideration for its investments in a pool that would be used to make microloans to promote economic development in a regional area that includes the institution's assessment area. Examiners would consider such an investment to be a qualified investment for the same reasons discussed above regarding purchases of promissory notes. Thus, for example, a large retail institution would receive favorable consideration under the investment test for investing in a microloan pool. See 12 CFR §§ 25.23(a), 228.23(a), 345.23(a), and 563e.23(a).

In lieu of consideration for the investment under the investment test, a large retail institution may elect to have its examiner consider, under the lending test, originations and purchases of community development loans by a consortium in which the institution participates or by a third party in which the bank has invested. See 12 CFR §§ 25.22(d), 228.22(d), 345.22(d), and 563e.22(d). Thus, a financial institution would be able to claim for CRA purposes its pro-rata share of the total loans originated from the pool. *Id.*<sup>5</sup>

## **2. Purchases of a Microloan Portfolio or Portfolio-Backed Security**

A financial institution's purchase of a microloan portfolio would be considered a purchase of the individual loans that comprise the portfolio. If a loan met the definition of loans to small businesses contained in the Instructions to the Consolidated Reports of Condition and Income or Thrift Financial Reports, an institution's purchase of the loan would be considered a purchase of a small business loan under the CRA regulations. If a loan did not meet the definition of small business loans but met the definition of community development loans under the CRA regulations, an institution's purchase of the loan would be considered a purchase of a community development loan. A large retail institution's record of helping to meet community credit needs through its purchases of small business loans or community development loans is evaluated under the lending test. See 12 CFR §§ 25.22(a)(1), 228.22(a)(1), 345.22(a)(1), and 563e.22(a)(1). Small business and community development loans may also be considered in the evaluations of small institutions and institutions evaluated based on a strategic plan.<sup>6</sup> See 12 CFR §§ 25.26(a)(1), 25.27(f)(1), g(3)(i), and pt. 25 app. A(d)(2); §§ 228.26(a)(1),

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<sup>5</sup> For further discussion of the CRA treatment of loans by consortia or third parties, see OCC Interpretive Letter No. 673 (June 26, 1995) (investment in a community development bank) and interagency letter published as OCC Interpretive Letter No. 710 (February 21, 1996) (treatment of loans made by an affiliate).

<sup>6</sup> Wholesale and limited purpose institutions' small business lending activities would be considered under the community development test if the small business loans qualified as community development loans. See 12 CFR §§ 25.25, 228.25, 345.25, and 563e.25.

228.27(f)(1), g(3)(i), and pt. 228 app. A(d)(2); §§ 345.26(a)(1), 345.27(f)(1), g(3)(i), and pt. 345 app. A(d)(2); and §§ 563e.26(a)(1), 563e.27(f)(1), g(3)(i), and pt. 563e app. A(d)(2).<sup>7</sup>

A financial institution's purchase of a microloan portfolio-backed security that financed microenterprises to promote economic development would be a qualified investment for the reasons set forth above in the discussion of purchases of promissory notes.

**C. Geographic Restrictions on a Financial Institution's Support for [Company]'s Existing or Proposed Programs.**

Under the CRA regulations, a retail financial institution's community development loans, investments, or services must primarily benefit its CRA assessment area but may also benefit a broader regional area (including a multiple-state area). Thus, a financial institution may receive favorable consideration for its support of a community development organization that operates on a statewide or regional basis that extends beyond the institution's assessment area(s). The community development organization's scope must include the financial institution's assessment area(s) so that the institution's investment potentially benefits its assessment area(s). The more direct or certain the benefit, the more likely it will be viewed as particularly responsive to community credit needs. Thus, examiners will give greater consideration for investments, loans or services that more directly benefit the institution's assessment area(s).

In order to receive consideration for its participation in such a community development organization, an institution must provide its examiner sufficient documentation to demonstrate that its investment benefits a regional area that includes the institution's assessment area. An institution need not document the location of each community development loan that results from its investment. See 60 Fed. Reg. at 22,172.

**III. CONCLUSION**

I trust this has been responsive to your inquiry. You may also be interested to know that the staffs of the four financial supervisory agencies are presently developing official guidance for the public for resolving interpretive questions arising under the new CRA regulations. If you have any questions in the meantime, please feel free to contact me at (202) 874-5750, Bert Otto of the Office of the Comptroller of the Currency at (202) 874-5224, Bobbie Jean Norris at the Federal Deposit Insurance Corporation at (202) 942-3090, Glenn Loney of the Federal Reserve Board at (202) 452-3585, or Timothy Burniston of the Office of Thrift Supervision at (202) 906-5629.

Sincerely,

/s/

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<sup>7</sup> In addition, a large institution would have to provide the loan documentation described in the CRA regulations' data collection, reporting, and disclosure sections. See 12 CFR §§ 25.42, 228.42, 345.42, and 563e.42.

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