INTRODUCTION TO EXAMINATION PROCEDURES

In This Section

BACKGROUND AND SUMMARY

The Community Reinvestment Act (CRA) of 1977 (12 U.S.C. 2901) as amended, encourages each insured depository institution covered by the Act to help meet the credit needs of the communities in which it operates. The CRA requires that each federal financial supervisory agency assess the record of each covered depository institution in helping to meet the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operations, and take that record into account when deciding whether to approve an application by the institution for a deposit facility.

Neither the CRA nor its implementing regulations inject hard and fast rules or ratios into the examination or application processes. Rather, the law contemplates an evaluation of each lender's record that can accommodate individual circumstances. Neither the CRA nor its implementing regulations require financial institutions to make high risk loans that jeopardize their safety. To the contrary, the law makes it clear that lending that meets an institution's CRA responsibilities should be done within the bounds of safety and soundness. Rebuilding and revitalizing communities through sound lending and good business judgment should benefit both the communities and financial institutions.

BACKGROUND AND SUMMARY (cont'd)

An institution's capacity to help meet community credit needs is influenced by many factors, including its financial condition and size, resource constraints, legal impediments and local economic conditions that could affect the demand and supply of credit. Examiners must consider these factors when evaluating an institution's performance under CRA. This is consistent with a fundamental underpinning of the CRA regulations – that the differences in institutions and the communities in which they do business preclude rigid and inflexible rules. Clear, flexible, and sensible performance criteria that accommodate differences in institutions and their communities, that minimize burden, that promote consistency and objectivity, and that allow examiners to be guided by common sense rather than adherence to mechanistic procedures, are embodied in the CRA regulations and the examination procedures.

For example, the CRA regulations provide for different evaluation methods to respond to basic differences in institutions' structures and operations. The regulations provide a streamlined assessment method for small institutions that emphasizes lending performance; an assessment method for large, retail institutions that focuses on lending, investment, and service performance; and an assessment method for wholesale and limited-purpose institutions based on community development activities. Further, the regulations also give any institution, regardless of size or business strategy, the choice to be evaluated under a strategic plan. This type of flexibility and customizing should permit institutions to be evaluated fairly and in conformance with their business approach.

EXAMINATION BURDEN REDUCTION

The complementary regulatory themes of flexibility, responsiveness, and objectivity are extended to the examination process as part of an overarching effort, among other things, to reduce the burden of the regulations and the examination on institutions. Indeed, both the regulations and the examination procedures reflect a conscientious effort to minimize burden on financial institutions. For example, examiners are encouraged to draw on the results of previous examinations of an institution for information about major product lines, business strategy and supervisory restrictions. This information is typically available from agency sources, and, often, can be reviewed off-site. Further, examiners may already have knowledge of an institution's community and local demographics from their own past visits to the institution or to others in the same area. In these cases, examiners should be able to develop a good understanding of the context in which an institution operates before the actual examination begins, and then just supplement and update that understanding upon arrival at the institution.

EXAMINATION BURDEN REDUCTION (cont'd)

The regulations focus on performance-based criteria, not process or documentation. Institutions are not to be evaluated on how well they ascertain community credit needs, market and advertise their products, or how actively members of their boards of directors/trustees participate in local community organizations or civic groups. Consequently, the paperwork burden long associated by institutions with these past evaluation factors has been eliminated, as has any consideration of these factors from the examination process.

This sets the stage for a more constructive, credible, efficient, and unobtrusive examination process that concentrates on results. Both the regulations and the examination procedures promote and establish evaluation methods based on reviewing objective data that institutions can also use to measure their own performance. This should further minimize burden since examination results will be more understandable, and, over time, more predictable.

Rather than a "one size fits all" examination, separate procedures have been developed for small and large institutions, as well as for those that are wholesale or limited-purpose, and those that are operating under an approved strategic plan. Further, examiners are expected to use common sense to tailor the examination to mitigate the burden on the institution, such as by performing some procedures in advance of the on-site examination. This tailoring allows examiners to take reasonable steps to reduce burden while ensuring that the examination process is more understandable for the institution.

PERFORMANCE CONTEXT

An institution's performance under the regulatory assessment criteria is evaluated in the context of information about the institution, its community, and its competitors. The examiner will review demographic and economic data about the institution's assessment area(s), and information about local economic conditions, the institution's major business products and strategies, and its financial condition, capacity, and ability to lend or invest in its community. Often, this review will be facilitated by gathering information from examinations of other institutions serving the same or similar assessment areas; reviewing information from other recent community contacts; and reviewing information about the assessment area developed cooperatively by the different agencies.

The examiner will also review information an institution chooses to provide about lending, investment, and service opportunities in its assessment area(s). However, the examiner cannot require the institution to create such information, nor will the examiner ask for any information other than what the institution may have already developed as part of its normal business practice.

PERFORMANCE CONTEXT (cont'd)

An examiner should not evaluate an institution on its efforts to ascertain community credit needs, market its products, geocode its loans, or record CRA-related discussions in its board minutes. An examiner cannot rate an institution on the quality of any contextual information that it may provide.

ROLE OF COMMUNITY CONTACTS

Interviews with local community, civic, or government leaders can help examiners learn about the community, its economic base, and local community development initiatives. They can also help examiners understand public perceptions of how well local institutions are responding to credit needs.

These interviews help provide balance to the examiner's understanding of the performance context. Community contact interviews normally take the form of personal meetings, but telephone conversations or larger group meetings may also be appropriate.

Information from community contacts can provide valuable insights to examiners, particularly to those who have relatively little experience or familiarity with an institution's assessment area(s). Contacts may be made as part of an examination, or prior to the start of an examination, and typically will be conducted by the examiners responsible for the CRA examination. However, wherever possible, the agencies will draw on recent local interviews conducted by other agency staff, or by other regulatory agencies with CRA responsibilities.

ASSESSMENT AREA CONSIDERATIONS

Institutions are required to identify one or more assessment areas within which the agencies will evaluate the institution's performance. In most cases, an institution's assessment area(s) will be the town, municipality, county, or some other political subdivision of the MSA in which its branches are located and a substantial portion of its loans are made. However, if an institution chooses, its assessment area(s) need not coincide with the boundaries of one or more political subdivisions (for example, counties, cities, and towns or MSAs), as long as the adjustments to those boundaries reflect the fact that the institution's assessment area(s) would otherwise be too large for the institution to serve, have an unusual configuration, or would include significant geographic barriers. When the assessment area(s) coincides with recognized political subdivisions, or has not changed in any way since the previous examination, examiners may not have to conduct a comprehensive reevaluation of the assessment area(s).

When evaluating an institution's performance, the examiner will use the assessment area(s) designated by an institution provided that it meets regulatory criteria. Only if the criteria have not been satisfied will the examiner revise the assessment area(s) so that it complies with the regulations. The revisions will be discussed with institution management, and the revised assessment area(s) will be used to evaluate performance. However, unless the assessment area(s)

ASSESSMENT AREA CONSIDERATIONS (cont'd)

reflects illegal discrimination, examiners will not consider problems with the designation of the assessment area(s) when assigning a rating to the institution. Consequently, burden associated with the delineation of communities and inconsistencies resulting from examiners criticizing community delineations as being too large at one examination and too small at the next should be eliminated.

SMALL INSTITUTION PERFORMANCE CRITERIA

The effect of regulatory and examination burden can be more pronounced in small institutions. Limited financial resources and staffing, and competitive factors often influence the way that small institutions can meet their responsibilities under CRA. In recognition of these factors, the regulations established a streamlined assessment method for small institutions that significantly reduces examination burden. The regulations contain only five performance criteria:

1. The institution's loan-to-deposit ratio adjusted for seasonal variation and, as appropriate, other lending related activities such as secondary market participation, community development loans or qualified investments;
2. The percentage of loans and other lending-related activities located in the institution's assessment area(s);
3. The distribution of lending among borrowers of different income levels and business and farms of different sizes;
4. The distribution of lending among geographies of different income levels; and
5. The institution's record of taking action, if warranted, in response to written complaints about its CRA performance.

Small institutions are eligible for a rating of Outstanding, as well as Satisfactory. An examiner may conclude that an institution's performance so exceeds the standards for a Satisfactory rating under the five core criteria that it merits a rating of Outstanding. In addition, at the institution's option, the examiner will consider the institution's performance in making qualified investments and in providing services that enhance credit availability in its assessment area(s) in order to determine whether the institution merits an Outstanding rating.

SMALL INSTITUTION PERFORMANCE CRITERIA (cont'd)

In carrying out their examination responsibilities, examiners should exercise judgment and common sense in deciding how much material to review and what steps are necessary to reach an accurate conclusion. For example, if an institution's assessment area(s) is comprised of only a few geographies, a geographic analysis of loans within the assessment area(s) may be inappropriate or unnecessary. Or, if an institution has done an analysis to determine where, and to whom, it is making loans in its assessment area(s) to assist itself in its business efforts, examiners may be able to validate and then use the institution's analysis rather than conduct a detailed analysis of their own. In other words, when evaluating the performance criteria, examiners should always consider and use available, reliable information.

Similarly, if an institution's loan-to-deposit ratio appears low, the examination procedures ask the examiner to evaluate the institution's lending-related activities, such as loan sales and community development lending and investments to determine if they materially supplement its lending performance as reflected in its loan-to-deposit ratio. However, such an analysis may not be necessary or a less extensive analysis may be sufficient if the loan-to-deposit ratio is high.

LARGE INSTITUTION PERFORMANCE CRITERIA

The large institution performance criteria – the Lending, Investment, and Service Tests – cover all institutions with assets of $250 million or more and institutions, regardless of asset size, owned by holding companies with total bank and thrift assets of $1 billion or more unless they requested designation and received approval as wholesale or limited-purpose institutions or have been approved for evaluation under a strategic plan.

As under the streamlined small institution procedures, examiners are expected to exercise judgment and common sense to minimize the burden imposed by the examination process, consistent with a complete and accurate assessment of performance. Therefore, for example, examiners may be able to use economic and demographic data analyzed in an examination of one institution in examinations of other institutions serving the same or similar assessment areas. Community contacts may also be combined to cover more than one institution in a given market. In cases where an institution has analyzed its CRA performance, examiners may use those analyses, after verifying their accuracy and reliability, and should supplement those analyses only where questions are raised. Examiners should consider any performance related information offered by an institution, but should only request information called for by examination procedures.

LARGE INSTITUTION PERFORMANCE CRITERIA (cont'd)

Large institutions do face burdens that small institutions do not, particularly related to data collection and reporting. However, the existence of those data in automated form will permit examiners to conduct much of the necessary analysis prior to the on-site examination and thereby reduce any disruptions caused by the presence of examiners at the institution. As in small institutions, examiners must be sensitive to the burden of the examination process and use judgment and common sense when conducting examinations. Examiners should perform only those steps necessary to arrive at an accurate assessment of the institution's performance.

WHOLESALE/ LIMITED PURPOSE (W/LP) PERFORMANCE CRITERIA

In order to be evaluated under the community development test, an institution must be designated as a wholesale or limited-purpose institution following submission of a written request to its primary regulator. Once an institution has received a designation, it will not normally have to reapply for that designation. The designation will remain in effect until the institution requests that it be revoked or until one year after the agency determines that the institution no longer satisfies the criteria for designation and notifies the institution of this determination.

Wholesale or limited-purpose institutions are evaluated on the basis of their:

- Community development lending, qualified investments, or community development services
- Use of innovative or complex qualified investments, community development loans, or community development services and the extent to which investments are not routinely provided by private investors
- Responsiveness to community credit and development needs

Examiners must be cognizant of the context within which a wholesale or limited-purpose institution operates. Examiners should recognize that these institutions may tailor their community development activities based on their own circumstances and the community development opportunities available to them in their assessment areas or the broader statewide or regional areas that include the assessment areas.

Institutions need not engage in all three categories of community development activities to be considered satisfactory under the community development test. Community development loans, investments and services can be directed to a statewide or regional market that includes the institution's assessment area(s) and still qualify for consideration under the community development test as benefiting the assessment area(s). Moreover, if an institution has a satisfactory community development record in its assessment area(s), all community development activities regardless of their locations should be considered.

W/LP PERFORMANCE CRITERIA (cont'd)

As with other performance tests, in applying the community development test, examiners should perform only those analyses that are necessary to reach an accurate conclusion about the institution's performance, use all available, reliable information, and avoid duplication of effort to reduce burden.

STRATEGIC PLANS

The regulations permit any institution to develop, and submit for approval by its primary supervisory agency, a strategic plan for addressing its responsibilities with respect to CRA. The regulations require that the plan be developed in consultation with members of the public and that it be published for public comment. The plan must contain measurable annual goals. A single plan can contain goals designed to achieve only a "Satisfactory" rating or, at the institution's option, can contain goals designed to achieve a "Satisfactory" rating, as well as goals designed to achieve an "Outstanding" rating.

This approach to addressing an institution's CRA responsibilities presents an opportunity for a very straightforward examination. The first question an examiner should investigate is whether the goals were met. If they were, the appropriate rating should be assigned. The appropriateness of the goals will have already been determined in the process of public comment and agency review and approval. Consequently, further investigation relating to the context of the institution should not be necessary. Obviously, if some or all of the plan's goals were not met, the examiner will be required to evaluate such issues as whether they were substantially met and in doing so will have to exercise some judgment regarding the degree to which they are missed and the causes.

However, the examiner should approach an examination of an institution operating under a plan understanding that part of the purpose for these regulatory provisions was to give the institution significant latitude in designing a program that is appropriate to its own capabilities, business strategies and organizational framework, as well as to the communities that it serves. Consequently, the institution may develop plans for a single assessment area that it serves, for some, but not all, of the assessment areas that it serves, or for all of them. It may develop a plan that incorporates and coordinates the activities of various affiliates. It will be the examiner's challenge to evaluate institutions operating under one plan or a number of plans in a way that accurately reflects the results achieved and that sensibly wraps that evaluation into the overall assessment of the institution.

STRATEGIC PLANS (cont'd)

As with other aspects of the CRA examination, the examiner should first make the greatest use possible of information available from the agencies to evaluate performance under the plan. However, it is likely that some elements of a plan under review will not be reflected in public or other agency data. Consequently, the examiner may, of necessity, have to ask the institution for the data necessary to determine whether it has met its goals. The examiner should do so, to the greatest extent possible, by asking the institution to provide data for review prior to going on-site for the examination. The examiner should also seek to mitigate burden by, wherever possible, using data in the form maintained by the institution.

FDIC LAW, REGULATIONS, & RELATED ACTS

Applicable Rules

Community Reinvestment Act of 1977, Volume 3, Page 8741

Part 345 – Community Reinvestment Act, Volume 1, Page 2781

Advisory Opinions

Applicability of Community Reinvestment Act to a Trust Company, Letter #91-73, Volume 1, Page 4583

Statements of Policy

None.

DCA MEMORANDA

Large Bank CRA Guidance, Transmittal # DCA-98-029, dated 12/21/98

Small Bank Scoping, Transmittal # DCA-97-6456.9, dated 4/24/98

Community Reinvestment Act Data Worksheets
DCA-97-6456.7, dated 8/21/97 – Incorporated in Supplemental Section

Guidelines for Referring Violations of the Anti-Discrimination Provisions of the Equal Credit Opportunity and Fair Housing Acts to the Department of Justice or Notifying the Department of Housing and Urban Development of Violations of the Fair Housing Act, Transmittal #DCA-003, dated 1/23/97

Procedures for Reviewing a Strategic Plan Submitted for Approval, Transmittal # DCA-97-6456.5, dated 1/22/97

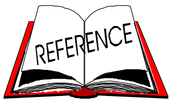
FFIEC Guidance for Small Bank Public Evaluations
DCA-96-6456.5, dated 12/17/96

CRA Rating Descriptions for Compliance Report
DCA-96-6456.4, dated 10/28/96

Guidance for Small Bank Public Evaluations
DCA-96-6456.3, dated 10/26/96

CRA Sampling Software
DCA-96-6456.1, dated 10/25/96

Examination Procedures for Advertisements and Public Notices, Transmittal #DCA-96-022, dated 2/22/96



DCA MEMORANDA (cont'd)

Pre-Examination Planning (PEP) Procedures, Transmittal # DCA-96-013, dated 1/31/96

General Workpaper Standards and Standardized Workpapers, Transmittal #DCA-96-003, dated 1/19/96

FINANCIAL INSTITUTION LETTERS (FIL)

Revised, New and Proposed Interagency Questions and Answers Regarding Community Reinvestment, Letter # 56-99, dated 6/17/99

Rescission of Community Reinvestment Act Policy Statement, Letter # 43-99, dated 5/11/99

Interagency Questions and Answers on the Revised Community Reinvestment Act Regulations FIL-30-97, dated 10/28/97

Guidelines for Strategic Plan Submissions FIL-26-98, dated 3/3/97

Designations as Wholesale or Limited-Purpose Institutions; Submissions of Strategic Plans, Letter #3-96, dated 1/11/96

Technical Amendments to Correct and Clarify New Rules Implementing the Community Reinvestment Act (Part 345), Letter #87-95, dated 12/27/95

Revised Regulation Implementing the Community Reinvestment Act (Part 345); Revision to Regulation C (Includes the Preamble), Letter #35-95, dated 5/17/95

OTHER

FFIEC Legal Advisory Opinion on the CRA amendments in the Interstate Banking and Branching Efficiency Act of 1994 (IBBEA), Incorporated into Supplemental section

Large Bank Reference Guide, Issued 12/16/97

OCC News Release, Department of Justice Opinion Released on Enforcement Action on CRA, dated 12/15/94