

Intermediate Small Bank CRA Examination

Presenters:

Penny B. King, Acting Community Affairs Officer
Christopher R. Self, Senior Compliance Examiner
John J. Henwood, Senior Compliance Examiner

FDIC

Atlanta Regional Office

September 19, 2014

Agenda

- ▶ Introduction
- ▶ Definitions
- ▶ Intermediate Small Bank (“ISB”)
 - Lending Test
 - Community Development Test
- ▶ Best Practices
- ▶ The Exam Process – Are you ready?

Intermediate Small Bank Definition

- ▶ “Intermediate small bank” means an institution with assets of at least \$300* million as of December 31 of both of the prior two calendar years, and less than \$1.202* billion as of December 31 of either of the prior two calendar years.

*Thresholds are as of 1/1/14

Performance Context

- ▶ What does bank management know about the local market and economy, relative to community development opportunities?
- ▶ Has loan demand changed, declined, increased, or remained stable?
- ▶ Have bank underwriting criteria become more or less conservative?
- ▶ Is the bank seeing deterioration in consumer credit scores/credit histories?
- ▶ Is the bank facing any liquidity or other constraints?
- ▶ Has the bank's business strategy or product offering changed as a result of current economic conditions?
- ▶ Are there any other relevant factors that may impact the bank's capacity or ability to lend?

ISB Examination Method

- ▶ Interagency examination procedures
- ▶ Available at:
 - www.ffiec.gov/cra/examinations.htm,
 - <https://www.fdic.gov/regulations/examinations/>
 - or FDIC Compliance Manual
- ▶ Two-prong test:
 - Small bank lending test, and
 - Community development test

What Are The Performance Factors?

Lending Test:

- ▶ Loan-to-Deposit ratio
- ▶ Lending in assessment area
- ▶ Lending to borrowers of different incomes and to businesses of different sizes
- ▶ Geographic distribution of loans
- ▶ Response to complaints

The Performance Factors

In addition to the Lending Test, an Intermediate Small Bank has the Community Development Test:

- ▶ Number and amount of community development loans
- ▶ Number and amount of qualified investments
- ▶ Extent to which the bank provides community development services
- ▶ Bank's responsiveness to identified community development lending, investment, and services needs

Community Development

- ▶ Community Development Loans
- ▶ Qualified Investments
- ▶ Community Development Services

Community Development

Interagency CRA Q&A dated March 11, 2010, §.12(g) discusses the definition of Community Development, and

§.12(h)-8 answers the question: *What is meant by the term “primary purpose” as that term is used to define what constitutes a community development loan, a qualified investment, or a community development service?*

Community Development

Community development as defined in the CRA regulation:

- ▶ Affordable housing for low- or moderate-income individuals
- ▶ Community services targeted to low- or moderate-income individuals
- ▶ Activities that promote economic development by financing small businesses or small farms that meet the size eligibility standards of the SBA's Development Company or Small Business Investment Company programs or have gross annual revenues of \$1 million or less

Community Development

- ▶ Activities that revitalize or stabilize low- or moderate-income areas, designated disaster areas, or underserved or distressed nonmetropolitan middle-income areas
- ▶ Loans, investments, and services that support, enable, or facilitate Neighborhood Stabilization Program (NSP) eligible activities in designated target areas

Community Development

Two approaches to determine primary purpose:

- ▶ First, does a majority of the dollars or beneficiaries of the activity benefit from the community development activity?
- ▶ Second, if less than majority of dollars, answer the following questions:
 - Is the express, bona fide intent of the activity consistent with the CRA definition of community development?
 - Is the activity structured to achieve that purpose?
 - Does the activity accomplish, or is reasonably certain to accomplish, that purpose?

Examples of CD Loans

Per §II.12(h)-1, includes loans to:

- ▶ Borrowers for affordable housing rehabilitation and construction, including construction and permanent financing of multifamily rental property serving low- and moderate-income persons;
- ▶ Borrowers to construct or rehabilitate community facilities that are located in low- and moderate-income areas or that serve primarily low- and moderate-income individuals; and
- ▶ Borrowers to finance environmental clean-up or redevelopment of an industrial site as part of an effort to revitalize the low- or moderate-income community in which the property is located.

Common CD Loan Questions

§II.12(h)–3 includes the following questions:

- ▶ May an intermediate small institution that is not subject to HMDA reporting have home mortgage loans considered as community development loans?
- ▶ May an intermediate small institution have small business and small farm loans and consumer loans considered as community development loans?

Response:

Yes. *At the institution's option*, provided they meet the regulatory definition of “community development.”

- ▶ For example,
 - Anytown Bank made a business loan of \$800,000 to a manufacturing plant located in a moderate-income census tract in its assessment area. The loan enabled the plant to create several new, permanent jobs for moderate-income individuals. This loan would not normally be considered as a CD loan because it is less than \$1MM. However, it does meet the primary purpose of revitalize or stabilize an LMI area because it created permanent jobs for LMI people. An intermediate small bank (and only an ISB) has the option of identifying this loan as either a CD loan or a small loan to a business. The ISB needs to consider where it needs the CRA consideration since it can not be used in both the lending test and the CD test.
- ▶ **Note: This option for ISBs does not apply if the bank opts to be examined using the large bank test.**

Qualified Investments

- ▶ *Qualified investment* means a lawful investment, deposit, membership share, or grant that has as its ***primary purpose*** community development.

Qualified Investments

- ▶ Performance Context
- ▶ Innovativeness or complexity of qualified investments are required to be considered if the bank is being examined as a large bank.
- ▶ Responsiveness to Community Development / Credit needs.

Qualified Investments

Per §11.12(t)-4, examples include:

- ▶ Deposits in minority- and women-owned financial institutions or low-income or community development credit unions that primarily lend or facilitate lending in low- and moderate-income areas or to low- and moderate-income individuals in order to promote community development.

Qualified Investments Example

- ▶ Investments in, or donations to, facilities that promote community development by providing community services for low- and moderate-income individuals, such as youth programs, homeless centers, soup kitchens, health care facilities, battered women's centers, and alcohol and drug recovery centers.

Designated Disaster Areas

- ▶ Investments receive credit that promote revitalization or stabilization in designated disaster areas. §11.12(g)(4)(ii)-1 defines “designated disaster areas”
 - The disaster area must be a Major Disaster Declaration designated by the federal government.
 - Receive credit for 36 months following date of designation
 - Reference www.fema.gov

Designated Disaster Areas

- ▶ §II.12(g)(4)(ii)–2 “What activities are considered to “revitalize or stabilize” a designated disaster area?”
 - An activity that helps to attract new, or retain existing, businesses or residents and is related to disaster recovery.
 - An activity will be presumed to revitalize or stabilize the area if the activity is consistent with a bona fide government revitalization or stabilization plan or disaster recovery plan.
 - Examples may include providing financing to help retain businesses in the area that employ local residents, including LMI individuals or providing financing to attract a major new employer that will create long-term job opportunities.

Community Development Service

Community development service means a service that:

- ▶ Has as its primary purpose community development;
- ▶ Is related to the provision of financial services; and
- ▶ Has not been considered in the evaluation of the bank's retail banking services.

Community Development Service

▶ First question:

- Is the primary purpose of this service consistent with the community development definition on slides 10 and 11?

▶ Second Question:

- Is the community development service provided by the bank employee related to the provision of financial services?

Examples of Community Development Services

Per §II.12(g)(2)–1 examples include:

- ▶ Community service provided to students or their families from a school at which the majority of students qualify for free or reduced lunch meals under the USDA National School Lunch Program
- ▶ Service targeted to individuals who receive or are eligible to receive Medicaid
- ▶ Service provided to recipients of government assistance programs that have income qualifications equivalent to, or stricter than, the definitions of LMI as defined by the CRA regulation

Examples of Community Development Services

Per §II.12(i) –3 examples include:

- ▶ Providing financial services to low- and moderate-income individuals through branches and other facilities located in low- and moderate-income areas, unless the provision of such services has been considered in the evaluation of the institution's retail banking services
- ▶ Providing technical assistance on financial matters to small businesses or community development organizations
- ▶ Providing credit counseling, home-buyer and home-maintenance counseling, financial planning or other financial services education to promote community development and affordable housing

Examples of Providing Technical Assistance

Per §II.12(i) –3 examples include:

- ▶ Serving on the board of directors
- ▶ Serving on a loan review committee
- ▶ Furnishing financial services training for staff and management
- ▶ Assisting in fund raising
- ▶ Providing services reflecting financial institution employees' areas of expertise at the institution such as human resources, information technology, or legal services

Best Practices

- ▶ Help all personnel understand the definition of community development
- ▶ Suggest a method for bank employees to record community development activity
- ▶ Periodically throughout the year collect and review the information to ensure the activity meets the CRA community development definition
- ▶ Perform an annual self-assessment

Best Practices

- ▶ Make a determination about which activities have a community development purpose
 - Don't provide examiners an extensive list of "possible" CD loans, services and investments to review
- ▶ Provide supporting information for the loan, investment or service
 - What information did the bank rely on to determine that the activity met the definition of community development? Does the non-profit serve predominantly LMI people, small farms, or small businesses?
- ▶ Consider tracking the number of hours of community development service performed
 - May help to demonstrate the level of services provided

Best Practices

- ▶ Remember, affordable housing is the only “element” where you can receive partial credit. So it is important to track the number of units supported with community development investments and loans and have adequate documentation.

Best Practices – Affordable Housing

Example 1:

- ▶ This \$100,000 loan funded the construction of 60 units; documentation shows 25 have been set-aside for those earning less than 30% of Area Median Family Income through Low Income Housing Tax Credit. Is this documentation sufficient? How much credit, if any, will the bank receive?
 - What if the loan funded 50 units? How much credit would the bank receive?

Best Practices – Affordable Housing

Example 2:

- ▶ This \$80,000 investment funded the construction of 80 units in a middle-income area of town; the only documentation provided to examiners was that 30 units were occupied by individuals earning less than 80 percent of the Area Median Family Income. Is this documentation sufficient? How much credit, if any, will the bank receive?

Best Practices

- ▶ Track which assessment area received benefit.
 - This will also help the bank self-identify weaknesses.
- ▶ Review the bank's donations/investments list. Banks often miss opportunities to maximize donations that are qualified investments.
- ▶ Develop a centralized process to record the type of activity, how it qualifies, and the assessment area impacted.

Best Practices

- ▶ Don't forget to consider the impact of disaster area declarations on the bank's investment opportunities
- ▶ Remember to include in services the organizations which your Board members are active
- ▶ Reach out to the community to determine what the needs are in your area

Best Practices

- ▶ Review what other banks are doing in your area by reviewing their Public Evaluations (PE).
 - <http://www.ffiec.gov/craratings/default.aspx>

The Examination Process: Are You Ready?

Steps Examiners Go Through When
Conducting a CRA Examination
And

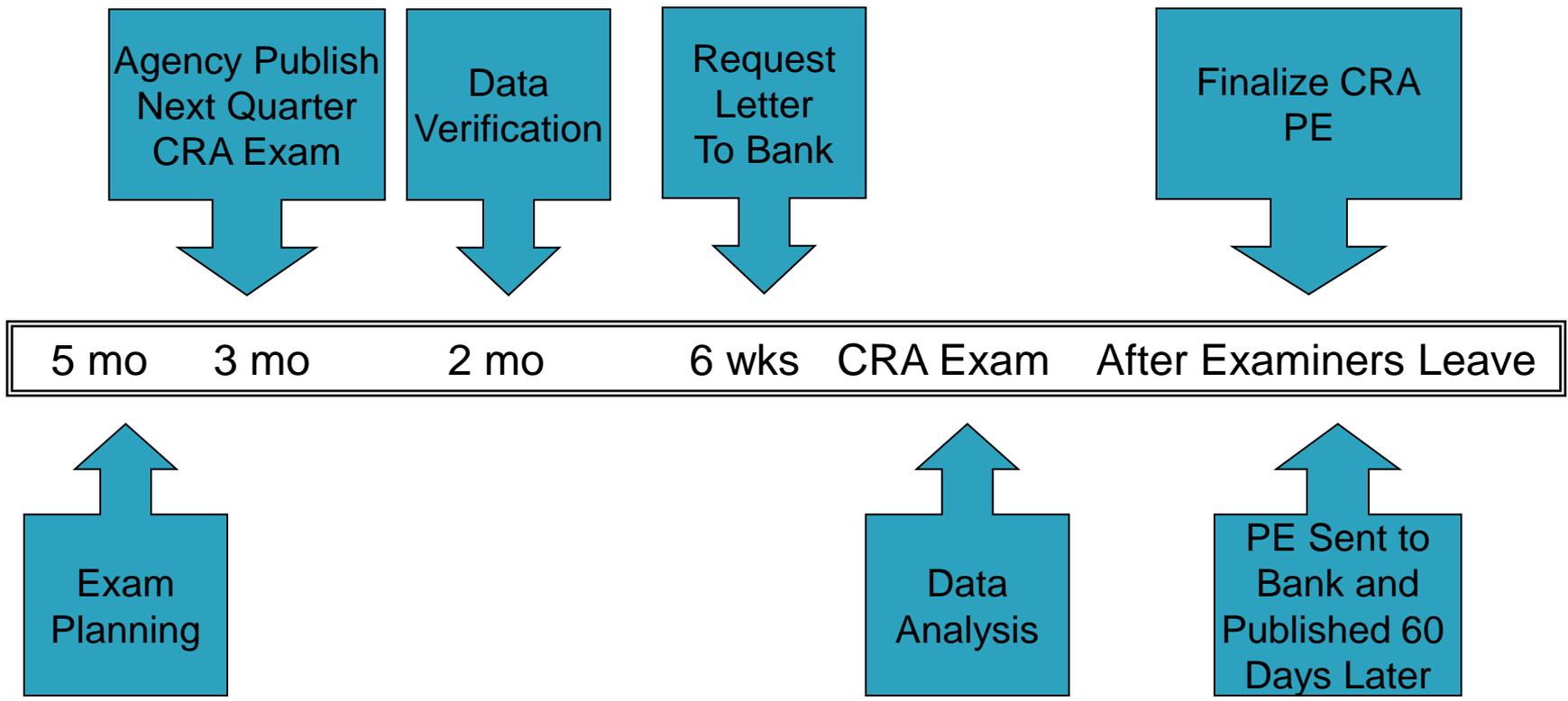
Steps CRA Officers Can Take to be Ready
for a CRA Examination



Objectives

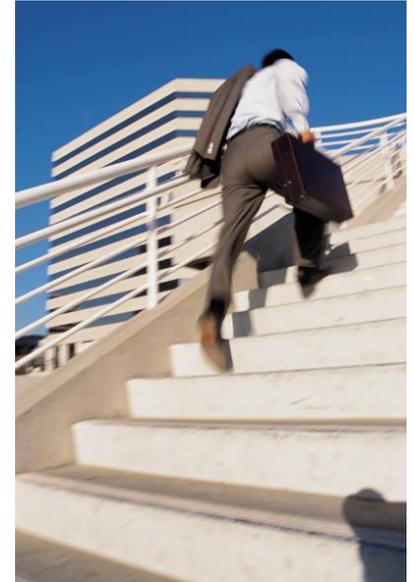
- ▶ Understand examination steps
- ▶ Understand what CRA Officers can do to prepare for examinations

Steps Examiners Go Through



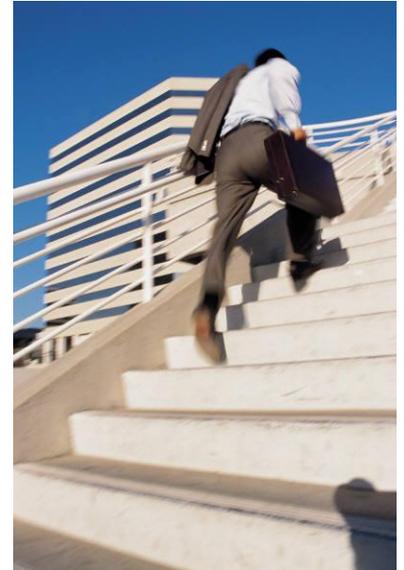
Steps CRA Officers Can Take to Be Exam Ready

- ▶ Review Request Letter
- ▶ Know your bank's Assessment Area(s)
- ▶ Check CRA public files to make sure they are up to date
- ▶ Document any important performance context issues – does the bank know its markets
- ▶ Document any items you want considered for community development



Steps CRA Officers Can Take to Be Exam Ready

- ▶ Know your primary products
- ▶ Perform a self-assessment (*not required*)
- ▶ Prepare a plan for the way you want the examiners to communicate with the bank –
 - either one bank liaison, or
 - a list of bank contacts



Questions

