

RESCINDED



Office of Thrift Supervision
Department of the Treasury

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Director

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May 16, 1995

**TO THE CHIEF EXECUTIVE OFFICER OF THE SAVINGS ASSOCIATION
ADDRESSED:**

The Federal financial regulatory agencies have promulgated a final rule revising the regulations that implement the Community Reinvestment Act (CRA). Enclosed is a copy of the final rule that was published in the Federal Register on May 4, 1995. See 60 Fed Reg 22156 (May 4, 1995).

The final rule results from an interagency effort requested by President Clinton to make CRA assessments more performance based, more objective, and less burdensome. Two proposals were published for comment and more than 14,000 comments were received and reviewed by the agencies in formulating the final rule. OTS received 843 comment letters on the first proposal, published on December 21, 1993, and 1081 comment letters on the October 7, 1994 proposal.

I. Overview

The final rule eliminates the twelve assessment factors in the current regulation and replaces them with performance tests. Institutions are no longer required to prepare CRA statements or extensively document board of directors participation, marketing efforts, or the ascertainment of community credit needs. Under the final rule, an institution's size and business strategy determines the type of examination it will receive. Large, retail-oriented institutions will be examined using the performance-based lending, investment and service tests. Small institutions will be examined using a streamlined approach. Wholesale and limited purpose institutions will be examined under a community development test. All institutions have the option of being evaluated under a strategic plan.

No matter what the test, each institution's performance will be evaluated in the context of its capacity and constraints, product offerings and business strategy, the credit needs of its community, its past performance and performance of similarly situated lenders, and any other relevant information. These considerations, taken as a whole, are the "performance context" that examiners will factor into their CRA evaluations.

The final rule does not require the collection of race and gender data for any loan customers or applicants. Rather, the Federal Reserve Board is proposing an amendment to Regulation B that would allow, but not require, lenders to collect race and gender information on credit applicants.

Large institutions are required to collect and report geographic data on small business and small farm loans under the final rule. Aggregate data on small business and small farm loans will be prepared by the agencies for inclusion in each institution's public file. The agencies will also make available to the public aggregate data regarding lending for all reporting institutions in each census tract.

II. Performance Tests and Ratings

A. Large Retail Institutions: Lending, Investment, and Service Tests

The lending, investment and service tests apply to all institutions over \$250 million in assets or part of a holding company with bank and thrift assets of over \$1 billion in assets. The lending test analyzes lending performance in reference to five performance criteria:

- o the number and amount of loans in the institution's assessment area;
- o the geographic distribution of lending, including the proportion of lending in the assessment area, the dispersion of lending in the assessment area, and the number and amount of loans in low-, moderate-, middle- and upper-income geographies in the assessment area;
- o borrower characteristics, such as the income level of individual borrowers and the size of business or farm;
- o the number and amount, as well as the complexity and innovativeness of an institution's community development lending; and,
- o the 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.

The investment test looks at four criteria in analyzing performance:

- o the dollar amount of qualified investments;
- o the innovativeness or complexity of qualified investments;
- o the responsiveness of qualified investments to credit and community development needs; and,
- o the degree to which the qualified investments made by the institution are not routinely provided by private investors.

The regulation recognizes the limited investment authority of thrifts in the performance context. Specifically, the final rule would permit an institution with limited investment authority to receive a low satisfactory rating under the investment test, even if it has made few or no qualified investments, if the institution has a strong lending record.

The service test looks at six criteria, four related to retail services and two related to community development services. The retail services considered in the examination are:

- o the institution's branch distribution among low-, moderate-, middle-, and upper-income geographies;
- o its record of opening and closing branches, particularly in low- and moderate-income geographies;
- o the availability and effectiveness of alternative systems for delivering retail banking services; and,
- o the range of services provided in low-, moderate-, middle- and upper-income geographies and extent to which those services are tailored to meet the needs of those geographies.

In addition, the examination will analyze the extent to which the institution provides community development services and the innovativeness and responsiveness of those community development services.

Examiners will assign one of five ratings to the institution's performance under each test: Outstanding, High Satisfactory, Low Satisfactory, Needs to Improve, and Substantial Noncompliance. The ratings under each test will consider the institution's performance context and reflect the circumstances in which it operates. Once the ratings for each test have been assigned, the final rule provides a matrix to determine the composite rating for the institution. The composite rating is one of the four statutory ratings - Outstanding, Satisfactory, Needs to Improve, or Substantial Noncompliance. In arriving at an overall rating for the institution, the agencies will consider fair lending examination results to determine whether the composite rating should be lowered because of discriminatory or other illegal credit practices.

B. Small Institutions: Streamlined Assessment Method

The final rule defines small institutions as independent institutions with total assets of less than \$250 million or institutions with assets less than \$ 250 million that are owned by a holding company with total bank and thrift assets of under \$ 1 billion. An institution will be considered small throughout any calendar year if, as of December 31 of either of the prior two calendar years,

the total assets of the institution (and, if applicable, its holding company) fell below the asset limits. See 60 FR 22162 (May 4, 1995) for a more detailed explanation.

Small institutions are examined under a streamlined test that looks at the institution's loan-to-deposit ratio adjusted for seasonal variation and special lending activities, its percentage of loans and other lending related activities in the assessment area, its record of lending to borrowers of different income levels and businesses and farms of different sizes, the geographic distribution of its loans, and its record of taking action, if warranted, in response to written complaints.

Small institutions do not have additional data reporting requirements under the final rule. Examiners will sample loan files to conduct their analysis under the streamlined assessment method.

C. Wholesale or Limited Purpose Institutions: Community Development Test

The community development test will be used to assess performance of wholesale and limited purpose institutions. The final rule defines wholesale institutions as those that are not in the business of extending home mortgage, small business or farm, or consumer loans to retail customers. Limited purpose institutions are defined as institutions that offer only a narrow product line (such as credit card or motor vehicle loans) to a region or submarket. Institutions must apply to their regulator for designation as a wholesale or limited purpose institution in order to be examined under the community development test.

The community development test has three performance factors:

- o the number and amount of community development loans, qualified investments, or community development services;
- o the institution's 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; and,
- o the responsiveness of the institution to the credit and community development needs of its assessment area.

The community development test allows agencies to consider an institution's activities outside of its assessment area if the institution has adequately addressed the needs of the assessment area.

D. Strategic Plan Option

All institutions are given the option of having their CRA performance assessed under an approved strategic plan. To exercise this option, institutions must informally seek suggestions from the public while developing its plan, solicit formal public comment on its plan for 30 days, and submit the plan to OTS with any written comments received from the public and a copy of the initial plan if changes were made in response to public comments.

To be approved, a strategic plan must have measurable goals and address how the institution plans on meeting the credit needs of its assessment area, particularly the low- and moderate-income areas in its assessment area through lending, investments, and services, as appropriate. Strategic plans should generally emphasize lending goals, however, the final rule does allow institutions the flexibility to tailor their approach to meeting their CRA obligations as necessary given their business strategy and the needs of their community.

Strategic plans must contain goals that, if met, would constitute "satisfactory" performance. If an institution would like to achieve a rating of "outstanding," goals that constitute outstanding performance must be included. An institution operating under a strategic plan will receive a satisfactory rating if it substantially achieves its satisfactory plan goals, and an outstanding rating if it substantially achieves its outstanding plan goals.

Strategic plans will be evaluated based on the extent and breadth of lending activity, the amount, innovativeness, complexity and responsiveness of institution's qualified investments, the availability and effectiveness of retail services, and the extent and innovativeness of community development services.

III. Assessment Area

The final rule contains guidelines for institutions to use in defining their assessment area. The assessment area is the geographic area in which the OTS will evaluate the institution's record of meeting the credit needs of its community. The rule provides that an institution's assessment area should consist generally of one or more MSAs or one or more contiguous political subdivisions, and include geographies where the institution has its main office, branches, and proprietary deposit-taking ATMs, as well as surrounding geographies where the institution has originated or purchased a substantial portion of its loans. An institution may adjust the boundaries of its assessment area to include only the portion of a political subdivision that it can reasonably be expected to serve. However, an institution's assessment area may not reflect illegal discrimination and may not arbitrarily exclude low- or moderate-income geographies, taking into account the institution's size and financial condition.

The final rule makes it clear that an institution's delineation of an assessment area is not evaluated as a performance factor. Examiners will use the assessment area defined by the institution in evaluating performance unless they find that it does not comply with the

requirements set forth in the rule. In those cases where the assessment area does not comply, the examiner will adjust the boundaries to comply with the rule and will use the adjusted assessment area to analyze performance.

IV. Data Collection, Reporting, and Disclosure

As mentioned in the discussion of the streamlined examination method, small institutions are exempt from data collection and reporting requirements. The final rule requires large institutions to collect data for small business and small farm loans. The rule requires institutions to collect, for each small business or small farm loan it makes: (i) the loan amount at origination; (ii) the loan location; and (iii) an indicator as to whether the loan was to a business or farm with gross annual revenues of \$1 million or less.

Large institutions must report to the agencies aggregate information to the agencies for each geography in which the institution originated or purchased a small business or small farm loan. These institutions must report the aggregate number and amount of loans in origination amounts of \$100,000 or less; between \$100,000 and \$250,000; and over \$250,000. In addition, reporting institutions must indicate the aggregate number and amount of loans to businesses or farms with gross annual revenues of \$1 million or less and the aggregate number and amount of community development loans originated or purchased.

A corresponding amendment to the HMDA regulations (also enclosed) requires large institutions that are also HMDA reporters to report the location of loans made outside of an MSA where they have a branch office.

In addition to the required reporting of small business and small farm loans, the final rule gives large institutions the option of collecting data on consumer loans that indicate loan amount at origination, loan location, and the gross annual income of the borrower. Institutions that opt to collect data on consumer loans may choose to collect the information for some consumer loan products and not others. However, if an institution chooses to provide data on one or more consumer loan product, it must provide data for all of the loans in that product category.

Data reported to the agencies will be used to prepare a "CRA Disclosure Statement" for each institution. The CRA Disclosure Statements will be prepared by the agencies for inclusion in each institution's public file.

For each county with a population of 500,000 persons or fewer, the CRA Disclosure Statement will contain: (i) the number and amount of small business and small farm loans located in low-, moderate-, middle-, and upper-income geographies; (ii) a list grouping each geography in the four income categories; (iii) a list showing each geography in which the institution reported a small business or small farm loan; and (iv) the number and amount of small business or small farm loans to businesses and farms with gross annual revenues of \$1 million or less.

For each county with a population in excess of 500,000 people, the CRA Statement contains: (i) the number and amount of small business or small farm loans located in geographies grouped by income deciles (less than 10% of median, 10% or more but less than 20%, etc., up to 120% of median or more); (ii) a list grouping each geography in these income deciles; (iii) a list showing each geography in which the institution reported a small business or small farm loan; (iv) the number and amount of small business or small farm loans to businesses and farms with gross annual revenues of \$1 million or less.

In addition, the CRA Disclosure Statement will contain the number and amount of small business or small farm loans located inside each assessment area, the number and amount of such loans located outside of all assessment areas, and the number and amount of community development loans.

The agencies will also prepare aggregate disclosure statements for each MSA that indicate, for each geography, the number and amount of all small business and small farm loans originated or purchased by all reporting institutions.

VI. Transition

The final rule will be phased in over a period of time and become fully effective by July 1, 1997.

Data collection requirements will become effective on January 1, 1996. The reporting requirements will become effective on January 1, 1997. Evaluations under the lending, investment, service, and community development tests will begin July 1, 1997, in order to allow the agencies to use the newly reported data. However, evaluations under the small bank performance standards, which do not utilize new data, will begin January 1, 1996. In addition, beginning January 1, 1996, any institution may submit a strategic plan for approval or elect to be examined under the revised performance tests, if the institution provides the necessary data.

The current regulation will be rescinded on July 1, 1997.

VII. Other Agency Initiatives to Implement the Final Rule

The final rule is just the first step toward implementing CRA reform. The agencies are working together to write examination procedures that will ensure that the goals of the regulation are met in the examination process. In addition, OTS examiners will participate in interagency training designed to promote consistent understanding and application of the regulation and examination procedures. Finally, the agencies will be working to provide examiners with the tools they will need to analyze CRA performance under the final rule.

I am looking forward to the implementation of this final rule. I believe it is a substantial improvement over the existing regulation and is responsive to the various criticisms the agencies have received about the way the existing regulation has been implemented. Finally, I want to take this opportunity to thank each of you who took the time to put together constructive and thoughtful comments on the two earlier proposals. The following Compliance Policy staff are available to answer any questions you may have on the final rule:

- Timothy R. Burniston -- (202) 906-5622
- Theresa Stark -- (202) 906-7054; or
- John Flannery -- (202) 906-7293.

Sincerely,

Jonathan L. Flechter
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 Acting Director

Enclosures

