



Comptroller of the Currency
Administrator of National Banks

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To: Prospective Community Development Bank Organizing Groups

From: Julie L. Williams, First Senior Deputy Comptroller and Chief Counsel

Subject: Community Development (CD) Banks

The Comptroller of the Currency (OCC) receives numerous inquiries and proposals from individuals and groups expressing interest in establishing a CD bank to conduct new business or converting existing operations into a CD bank. The purpose of this memorandum is to outline the criteria the OCC uses in granting a CD bank charter, explain the assistance OCC may provide to organizers of CD banks, and state the factors the OCC considers to be critical to the success of any *de novo* CD bank.

What Is a CD Bank?

A CD bank is a depository institution with a stated mission primarily to benefit the underserved communities in which it is chartered to conduct business. A CD bank pursues this specialized mission by providing financial services to low- and moderate-income (LMI) individuals or communities or benefiting other areas targeted for redevelopment by local, state, tribal, or federal government.

The OCC grants a special CD designation to banks that intend primarily to engage in these CD activities. The bank's articles of association must indicate the express intent primarily to lend, invest, and provide services in the underserved communities in which it is chartered to conduct business. The OCC designates a bank as a CD bank after a review of the charter application (*de novo* CD bank) or business plan (conversion to a CD bank). CD banks must meet the same safety and soundness, statutory, regulatory, business planning, and procedural requirements as all other national banks.

Applying for a CD Bank Charter

For organizers of *de novo* CD banks, the guidelines for applying for a national bank charter are outlined in the following OCC publications, which are available on the OCC's Web site and from the OCC's district licensing offices (locations and telephone numbers are also available in the "Corporate Applications" section of the OCC's Web site at www.occ.treas.gov):

- *A Guide to the National Banking System*
- *Comptroller's Corporate Manual* in booklets dealing with:
 - Charters (*de novo* and conversions)
 - Corporate Organization
 - General Policies and Procedures
 - Background Investigations
 - Public Involvement
- *A Guide to Tribal Ownership of a National Bank*

In addition to the required submissions outlined in these publications, CD banks must provide the OCC a proposal describing how and why the bank is eligible for and seeking the CD designation with specific information documenting

- How the bank's activities will primarily benefit LMI individuals, LMI areas, or other areas targeted for redevelopment by local, state, tribal, or the federal government, and
- The nature of the non-bank community involvement.

How Can National Banks Invest in CD Banks?

A national bank may make an investment in a CD bank either under the statute and regulation pertaining to community development corporations (CDCs), CD projects, and other public welfare investments (12 USC 24 (Eleventh) and 12 CFR Part 24), or under its broad authority to engage in the business of banking and activities incidental thereto (12 USC 24 (Seventh)). A bank may also receive credit under the Community Reinvestment Act (CRA) for investing in a CD bank.

A national bank may make an investment pursuant to the provisions of 12 USC 24 (Eleventh), provided that the CD bank's loans, investments, and services primarily benefit LMI individuals, LMI areas, or other areas targeted for redevelopment by state, local, tribal, or the federal government by providing or supporting one or more of the items listed below:

- Affordable housing, community services, or permanent jobs for LMI individuals
- Equity or debt financing for small businesses
- Area revitalization or stabilization
- Other activities, services, or facilities that primarily promote the public welfare

National banks seeking to make an investment in a CD bank under this authority should follow the procedures outlined in 12 CFR Part 24 (information is available on the Community Affairs page of OCC's Web site under "Publications and Resource Materials"). It should be noted that, typically,

a national bank's total investment under the Part 24 authority is limited to 5 percent of its capital and unimpaired surplus, although it may go as high as 10 percent, with OCC approval.

Alternatively, a national bank may make a noncontrolling investment in a CD bank following the provisions of 12 USC 24 (Seventh), provided that the following provisions of 12 CFR 5.36 are met:

- The activities of the CD bank in which the investment is made must be limited to activities that are part of, or incidental to, the business of banking (or otherwise authorized for a national bank).
- The investing bank must be able to prevent the CD bank from engaging in activities that do not meet the foregoing standard, or be able to withdraw its investment.
- The investment in the CD bank is convenient and useful to the investing bank in carrying out its business and not a mere passive investment unrelated to the bank's banking business.
- The investing bank's loss exposure in the CD bank must be limited, as a legal and accounting matter, and the bank must not have open-ended liability for the obligations of the enterprise.

Regardless of which investment authority is used, an investing bank that would have a significant ownership interest in a CD bank should consult the Federal Reserve to determine whether its investment would cause the investing bank to be deemed a bank holding company under the Bank Holding Company Act.

Can National Banks Purchase Subordinated Debt of CD Banks?

National banks may invest in subordinated debt of a CD bank. Such investment may be eligible as Tier 2 capital for the CD bank and thus can enhance a CD bank's ability to supplement its capital base. However, it should be noted that the inclusion of term subordinated debt in Tier 2 capital is limited to 50 percent of the CD bank's Tier 1 capital (see appendix A of 12 CFR Part 3).

How Can State-Chartered Banks and Bank Holding Companies Invest in CD Banks?

State-chartered banks may be able to invest in CD banks pursuant to the Federal Reserve Board's Regulation H (for state member banks) or the FDIC's rules set forth at 12 CFR Part 362 (for state nonmember banks). Bank holding companies also may be able to make investments in CD banks following the provisions of the Federal Reserve Board's Regulation Y. The Federal Deposit Insurance Corporation (FDIC) can provide more information about 12 CFR Part 362. The Federal Reserve Board or the Federal Reserve Banks (FRB) can provide more information about Regulations H and Y.

Technical Assistance Available to CD Bank Organizers

The OCC provides technical assistance upon request to the organizers of *de novo* CD banks, during the charter exploratory, planning, and pre-filing period. An OCC team of licensing, supervision, legal, and community affairs staff is available to meet with organizers to provide information and

feedback on issues related to a *de novo* bank's proposed business plan and CD focus. The OCC encourages prospective applicants to contact the OCC's district licensing staff that serve the area in which the bank will be located to discuss corporate proposals.

After these initial discussions, groups that have explored all charter and community development aspects of their application are encouraged to submit a draft application to the OCC prior to the submission of their formal application. The OCC considers it important that the initial draft be as complete as possible.

For a listing of phone numbers and more detailed information on the specifics of the application requirements and timeframes, please visit the "Corporate Applications" page of the OCC's Web site.

Key Factors to Consider When Organizing a CD Bank

It is the OCC's policy to approve proposals to establish national banks that will operate in a safe and sound manner and have a reasonable chance of success. The OCC's decision whether or not to grant a new charter application depends on an assessment of the organizing group's qualifications, choice of management and directors, and the strength of its business/operating plan, including capitalization, contingency planning, and financial projections.

CD banks face unique challenges in accomplishing the dual objectives of being profitable institutions operated in a safe and sound manner and fulfilling their mission to focus on activities that promote the public welfare. Based on the OCC's experience working with CD banks that have been chartered and are now in business, the agency has identified the following areas deserving special attention by entities seeking to establish or convert to a CD bank.

Contact with Community Organizations

It is important that, early in the process of organizing or converting to a CD bank, organizers meet with local community organizations to engage them in a dialogue on CD needs in the geographic area in which the bank will be operating. This will help determine local community credit needs which must be demonstrated as part of any *de novo* bank charter application or existing bank's conversion to a CD focus. The OCC would view positively an organizing group that has strong ties in the community where it wishes to operate the bank.

Diversified Asset Base and Income Stream

Organizers must consider how a *de novo* institution will operate in a safe and sound manner, given its CD focus. Often, this means the bank's plans should serve both a broader market as well as its primary CD-focus market in order to lay a broad foundation for its future operations. Diversified asset and liability portfolios, product selection, funding sources, and target markets help make a bank less vulnerable to a downturn in any one market that could significantly affect its income or liquidity.

In the early stages, organizers of CD banks likely will need to develop a business plan that addresses not only the underserved communities that are its special focus but also more traditional, full service

retail banking activities. These services may encompass a wider geographical area than a CD bank's targeted communities, particularly in the early years of operation. During this "ramping-up" period, this mix of business can help a CD bank to grow into a healthy and profitable institution while still meeting its overall mission of serving targeted areas. An exclusive focus on underserved markets in a CD bank's early years simply may not generate enough business to enable the *de novo* institution to become viable and may subject it to a higher risk profile than desirable. The ramping-up period will vary depending upon the bank's business plan, as well as economic and market conditions, and may last for several years.

Capital Adequacy

The OCC's chartering policy in 12 CFR 5.20 states that a proposed bank must have capital sufficient to protect against the various risks inherent in the bank's operating plan. This initial capital raised is net of organizing expenses that will be charged to the bank's capital after it begins operations. An organizing group must therefore raise a sufficient amount of capital to pay all organization costs, compete effectively in the market area, and support planned operations adequately. Additionally, initial capitalization must be sufficient to maintain adequate capital levels until the bank achieves profitable operations. A *de novo* CD bank's business plan should also identify sufficient capital to address uncertainties in the marketplace and should demonstrate a clear ability to raise additional capital, if needed.

The OCC has not formally established a minimum capital level for *de novo* banks. The initial capital plan of a CD bank is reviewed against the bank's operating plan to determine if the proposed capital will be sufficient to support the projected volume and type of business the organizing group has proposed. The OCC, as the primary supervisor of national banks, will require proposed banks, including CD banks, with higher risk profiles to have higher capital reserves than proposed banks that present lower risk. For example, recent CD bank charter approvals have presented capital plans in the range of \$6.2 million to \$7.5 million with various applications incorporating different risk factors. The FDIC requires that, as a condition of granting deposit insurance, *de novo* banks maintain a Tier 1 capital-to-assets ratio of not less than 8 percent through the first three years of operation. (See *FDIC Statement of Policy on Applications for Deposit Insurance* at www.fdic.gov/lawsregs/rules/5000-9.html.)

Financial Assistance from the Community Development Financial Institutions (CDFI) Fund

The Treasury Department's CDFI Fund can provide additional sources of financial assistance for CD banks under the two programs described below. However, organizers of CD banks should understand key provisions of these programs, specifically, how they may limit flexibility or otherwise affect the bank. Information on these programs may be obtained from the Treasury Department Web site located at <http://www.cdfifund.gov/>.

CDFI Core Component Program: This program builds the financial capacity of CDFIs by providing equity investments, grants, loans, or deposits to enhance the capital base of CDFIs. In addition, under the Core Component Program, technical assistance grants are provided to CDFIs to build their capacity to address the CD needs of their target markets.

Bank Enterprise Act (BEA) Awards: The BEA program provides monetary incentives for banks and thrifts to expand their investments in CDFIs or to increase their lending, investment, and service activities in distressed communities. BEA monies are awarded on a competitive basis to institutions that apply for the funds and meet agreed-upon performance goals.

Bank Management/Board of Directors

The OCC requires each organizer to have a history of responsibility, personal honesty, and integrity. While personal wealth is not a requirement for a bank organizer or director, poor management of personal financial affairs will have a negative impact on the OCC's decision. Additional information on these topics can be found in the OCC's booklet on "Background Investigations" in the "Corporate Policies" section of the *Comptroller's Corporate Manual* and on the OCC's Web site.

The management team of a CD bank should demonstrate the experience, competence, and willingness to operate a CD-focused institution. Organizers should recognize that the selection of a qualified CEO is one of the most important decisions they will make. The risks associated with a CD bank require that the proposed CEO be actively involved in developing the business plan, have strong leadership skills, and be an experienced banking executive. The CEO should have skills that complement those of the directors and other proposed members of the executive officer team. Also, the unique characteristics of a CD bank business plan and the specific needs of its customers often require the management team to be comprised of individuals who understand CD and have worked with the LMI community.

Likewise, CD bank directors should have a balance of banking experience and knowledge of local community credit needs in order to keep the institution focused on becoming profitable while fulfilling its mission. It is vitally important that proposed directors of *de novo* CD banks fully understand and be committed to the institution's proposed operating plan. Given the great importance of selecting proper management and directors, the OCC suggests early discussions with its staff for guidance regarding best practices in the selection process. Many problems may be avoided when care is exercised in this process.

The proposed management team must, either individually or collectively, possess extensive knowledge and experience with the highly specialized lending products and lines of business typically proposed by CD banks (e.g., Small Business Administration and Federal Housing Administration programs). An organizing group should match carefully the skills of the management team to the specialized lending products and services that the CD bank will offer.

General information about the role of directors can be obtained in *The Director's Book: The Role of a National Bank Director* (available on the "Publications" page of OCC's Web site).

Partnerships with Other Banks

Other financial institutions that invest in a CD bank may be operating in the same market and have considerable experience and talent to offer in an advisory role to that CD bank. Investor institutions are able to assist CD banks in a number of ways, including

- Providing an “officer-on-loan” for temporary training assistance
- Consulting and training on operations, and
- Establishing two-way referral/correspondent relationships on loan business.

The OCC encourages CD banks to learn as much as they can from investor banks that have developed CD banking expertise in similar markets and lines of business.

However, the OCC has often seen bank investors conclude their relationships with a CD bank after providing initial capital, perhaps because of perceived prohibitions under the Depository Institutions Management Interlocks Act (DIMIA) (12 USC 3201 *et seq.*) which generally prohibits management officials from serving on the board of directors of an unaffiliated bank. While these regulations should be researched based on the specific circumstances, there are some exceptions that may be available. These exceptions allow management officials of an established bank to serve on the board of an unaffiliated CD bank that provides services in an LMI area, is minority- or women-owned, or is newly chartered. In cases where a management official of a national bank seeks to serve on the board of an unaffiliated CD bank, the bank may request the OCC to grant a waiver from the DIMIA restrictions. Such requests must be made in writing to the OCC’s licensing staff and, where appropriate, are normally granted for three years for established banks and two years for *de novo* banks.

There is also a “small market share” exemption to the DIMIA management interlock restrictions where the two “interlocking” banks together hold less than 20 percent of the deposits in their community or relevant metropolitan statistical area. Banks need not seek OCC approval for this exemption but they must maintain records to support their qualification for this exemption.

Representatives of banks also may serve on an advisory board or as an honorary director of a CD bank, provided that the CD bank’s total assets are less than \$100 million. If a CD bank’s assets exceed this level, then the interlock provisions (and exceptions) described above would apply.

A bank investor in a CD bank that seeks to place one of its management officials on the board of a CD bank should also consult the Board of Governors of the Federal Reserve System or the Federal Reserve Banks concerning certain prohibitions under the FRB’s Bank Holding Company Act rules and interpretations governing control of banks.

Funding and Liquidity

Some CD banks have found that lending and investing needs in their target communities exceed available core deposits in these areas. Consequently, some CD banks have turned to philanthropic and corporate investors located outside of their service areas to make deposits in the bank. There may be higher costs associated with reliance on these types of funding sources (see the “Liquidity” booklet of the *Comptroller’s Handbook* which is available on the “Publications” page of the OCC’s website). CD banks relying on these types of funds should be prepared to document to their examiners the sources of these funds and the degree to which these funds demonstrate credit and rate

sensitivity. CD banks should have contingency plans to replace these funding sources if the deposits are withdrawn.

CD Banks' CRA Evaluation

CD banks are evaluated under the same CRA criteria as all other community banks. Holding a CD charter is not a guarantee of an "Outstanding" CRA rating. Organizers, management, and directors should recognize that, due to the unique risks associated with a CD bank's niche market, the institution may need to pursue its CD mission by gradually ramping up its CD activities in order to concentrate on the fundamentals of safety and soundness, prudent growth, and profitability during its early years. Thus, a CD bank's CRA performance may not be as strong in its early years as it will become as its business and marketing plan develops.

Communications with the OCC

Responsibility for the direction and management of a CD bank rests with the bank's board of directors and senior management team. The OCC's national bank examiners (NBEs) and district community affairs officers (DCAOs) will not participate in setting policies or directing the bank.

However, given CD banks' unique challenge to be profitable institutions, operate in a safe and sound manner, and fulfill their CD mission, the OCC encourages CD banks to maintain an ongoing dialogue with their NBEs and DCAOs. As part of the OCC's supervisory process and through quarterly reviews of bank performance, the OCC will work with CD banks to identify risks to the bank and suggest methods of approaching potential problems. As part of the supervisory process, the OCC will provide information on compliance, risk management, and operational issues facing the bank. Experts are also available in each district to provide guidance on subjects such as credit and asset management, consumer compliance, capital markets, bank information systems, legal issues, and economic conditions.