



Office of the Comptroller of the Currency

CRA Interpretations - Letter 723

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Dear []:

This letter responds to your inquiry regarding the application of Community Reinvestment Act (CRA) regulations to a financial institution's purchases of debentures issued by []. 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 issue you raised, and they concur in the opinions expressed in this letter.

As your letter explains, [] is a specialized small business investment company (SSBIC) that makes loans to, and investments in, small minority-owned businesses. These businesses must meet certain size specifications set out in regulations of the Small Business Administration (SBA) governing the SBA's small business investment company program. [] is interested in selling unsecured debentures to raise capital to continue its small business lending and investment programs. These debentures will be \$100,000 each and will not be rated by a private rating agency.

You have asked whether a financial institution would receive positive CRA consideration for the purchase of an SSBIC debenture, and whether the purchase would be considered a "qualified investment" or a "community development loan" under the new CRA regulation. <NOTE: This letter addresses only whether a purchase of the debentures would receive favorable CRA consideration. It does not address whether such a purchase would be lawful. The CRA does not provide financial institutions with any independent authority to make loans or investments. Furthermore, the agencies do not endorse particular lending or investment products.> The new CRA regulation provides a detailed framework for evaluating an institution's CRA performance. The new rule sets 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" or a "community development loan" that benefits its assessment area or a broader statewide or regional area that includes the assessment area. As explained below, depending on the nature of the transaction, an institution's purchase of an SSBIC debenture could be considered either a qualified investment or a community development loan.

Federal law limits the types of investment securities that financial institutions may purchase for their own account. *See, e.g.,* 12 U.S.C. 24(Seventh) (applicable to national banks), 335 (state member banks), 1831a(c) and (f) (state non-member banks), and 1464(c) (federal thrifts). For example, a national bank may invest in debentures only if they are readily marketable. *See, e.g.,* OCC Interpretive Letter No. 703

(January 26, 1996). However, banks also have authority to make certain investments that are primarily designed to promote the public welfare. *See, e.g.*, 12 U.S.C. 24(Eleventh) and 12 C.F.R. part 24 (authorizing national banks to make public welfare investments); and 12 C.F.R. 225.25(b)(6) (permitting bank holding companies to make equity and debt investments to promote the public welfare).

If an institution could demonstrate that the debentures are legally authorized investments, the debentures would be considered "qualified investments" under the CRA regulation. The new CRA regulation defines "qualified investment" as "a lawful investment, deposit, membership share or grant that has as its primary purpose community development." *See* 60 Fed. Reg. at 22,180, 22,191, 22,202, and 22,213 (to be codified at 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 businesses [that meet the size specifications in regulations governing the SBA's small business investment company and small business development company programs]." *See* 60 Fed. Reg. at 22,179, 22,191, 22,202, and 22,213 (to be codified at 12 CFR 25.12(h)(3), 228.12(h)(3), 345.12(h)(3), and 563e.12(g)(3)).

A purchase of an SSBIC debenture has as its primary purpose community development because the debenture enables the SSBIC to continue its small business lending and investment programs pursuant to SBA guidelines. Moreover, the debenture has a covenant that requires the use of proceeds from the debenture in the assessment area of the bank or thrift that purchases it. Therefore, assuming the purchase of the debenture qualifies as an investment, examiners would give positive consideration to the purchase as a qualified investment under any of the new performance tests and standards in the new CRA regulations. **<NOTE:** Examiners of large institutions, which are evaluated under the lending, investment and service tests, consider qualified investments under the investment test. *See* 60 Fed. Reg. at 22,181, 22,192, 22,204, and 22,215 (to be codified at 12 CFR 25.23(a), 228.23(a), 345.23(a), and 563e.23(a)). In a small institution examination, examiners may consider, if appropriate, qualified investments as other lending-related activities. *See* 60 Fed. Reg. at 22,182, 22,193, 22,205, and 22,216 (to be codified at 12 CFR 25.26(a), 228.26(a), 345.26(a), and 563e.26(a)). Qualified investments may also be considered to determine if a small institution merits an outstanding CRA rating. *See* 60 Fed. Reg. at 22,188, 22,200, 22,211, and 22,223 (to be codified at 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 institutions designated as wholesale and limited purpose institutions, evaluates, *inter alia*, the number, amount, complexity and innovativeness of qualified investments. *See* 60 Fed. Reg. at 22,182, 22,193, 22,204, and 22,215 (to be codified at 12 CFR 25.25(c)(1) and (2), 228.25(c)(1) and (2), 345.25(c)(1) and (2), and 563e.25(c)(1) and (2)). 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. *See* 60 Fed. Reg. at 22,183, 22,194, 22,205, and 22,216 (to be codified at 12 CFR 25.27(f)(1), 228.27(f)(1), 345.27(f)(1), and 563e.27(f)(1) (emphasis added)). A strategic plan will be evaluated on the basis of, *inter alia*, the amount and innovativeness, complexity and responsiveness of the institution's qualified investments. *See* 60 Fed. Reg. at 22,183, 22,194, 22,205, and 22,216 (to be codified at 12 CFR 25.27(g)(3)(ii), 228.27(g)(3)(ii), 345.27(g)(3)(ii), and 563e.27(g)(3)(ii)). >

Similarly, if a SSBIC debenture were carried on a financial institution's books as a loan rather than as an investment, the loan would be considered a community development loan under the new CRA regulation. A community development loan, like a qualified investment, receives favorable consideration under any of the evaluation methods in the CRA regulation. **<NOTE:** *See* 60 Fed. Reg. at 22,179, 22,190, 22,202, and 22,213 (to be codified at 12 CFR 25.12(i), 228.12(i), 345.12(i), and 563.12(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* 60 Fed. Reg. at 22,180, 22,192, 22,203, and 22,214 (to be codified at 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* 60 Fed. Reg. at 22,180-181, 22,192, 22,203, and 22,214 (to be codified at 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* 60 Fed. Reg. at 22,182-83, 22,193-94, 22,204-05, 22,215-17 (to be codified at 12 CFR 25.25(c), 25.26(a), 25.27(f)(1), (g)(3)(i),

and pt. 25 app. A(d)(2); 228.25(c), 228.26(a), 228.27(f)(1), (g)(3)(i), and pt. 228 app. A(d)(2); 345.25(c), 345.26(a), 345.27(f)(1), (g)(3)(i), and pt. 345 app. A(d)(2); and 563e.25(c), 563e.26(a), 563e.27(f)(1), (g)(3)(i), and pt. 563e app. A(d)(2)).> Thus, examiners will favorably consider as a community development loan the purchase of an SSBIC debenture such as the one you have described.

I trust this letter 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 written guidance to assist in resolving interpretive questions arising under the new CRA regulation. In the meantime, if you have any further questions, please feel free to call me or Michele Meyer, an attorney on my staff, at (202) 874-5750.

Sincerely,

/s/

Matthew Roberts

Director

Community and Consumer Law Division

Office of the Comptroller of the Currency