
**Office of the Comptroller of the Currency
Federal Deposit Insurance Corporation
Federal Reserve Board
Office of Thrift Supervision**

**Interpretive Letter #797
September 1997
12 U.S.C. 2901**

September 2, 1997

[]
[]
[]
[]

Dear []:

This letter responds to your correspondence regarding consideration under the Community Reinvestment Act (CRA) regulations of an investment in socio-economic investment notes (Notes) offered by SEinvestors Fund (Fund).

Background

You state that the Fund is a wholly owned, but semi-autonomous, fund created by the []. You state that [] is a not-for-profit corporation whose threefold principal purpose is:

1. To improve business and commercial opportunity for economically or socially disadvantaged individuals or businesses in the State;
2. To provide business development training and consulting services for such individuals and businesses; and
3. To promote and facilitate small business access to capital sources.

You indicate that the Notes in which you seek to have financial institutions invest would constitute general obligations of [] and would be fully subordinated to the right of repayment of all other creditors of []. You also note that financial institutions investing in the Notes would not be permitted to accelerate their payment and that interest on the Notes would not be tied to any income received by []. The prototype “[] Investment Agreement” (Prototype Agreement) that accompanied your letter states that the Fund will redeem the Notes not later than 120 months from the date of the note. The Prototype Agreement also states that not less than ninety percent (90%) of the proceeds of the financial institutions’ investments will be used to capitalize the Fund, which will provide debt and/or equity

capital for micro-enterprises located in or serving markets that have “development programs.” The discussion document accompanying your letter entitled “[] and [] Bank” ([] document) defines the term “development programs” as “planned employment by government or by private sector entities of economic incentives to produce outcomes that include defined communal benefits.” “Defined communal benefits” apparently include the following:

1. Expanding wholesome job opportunities for development area residents;
2. Raising the level and quality of civility in development areas; and
3. Creating communal benefit allowances¹ among all firms servicing markets in development areas.

See [] document. You indicate that you expect financial institutions to book the Notes as investments following generally accepted accounting principles.

As you know, the CRA regulations establish the framework and criteria by which the four bank and thrift regulatory agencies (Agencies) assess an institution’s record of helping to meet the credit needs of its community. The Agencies have promulgated substantively identical CRA regulations.² Therefore, staff from all of the Agencies (Staff) have considered the issues you raise and concur with the opinions expressed in this letter.

In order to provide broadly applicable guidance, this letter will focus on how an examiner would determine whether a financial institution would receive favorable CRA consideration for its investment in your fund or similar funds. The Agencies do not, however, issue letters such as this in order to endorse any particular programs.

Discussion

The CRA regulations provide methods for evaluating a financial institution’s CRA performance depending on the size of the institution and its business strategy. Regardless of the performance test under which a regulated financial institution is evaluated, an institution can receive positive consideration for making qualified investments³ that benefit the

¹The 21st Century document does not define the term “communal benefit allowances.”

²12 C.F.R. parts 25, 228, 345, and 563e.

³Large institutions’ CRA performance is typically evaluated under the lending, investment and service tests. Examiners consider large institutions’ qualified investments under the investment test. See 12 C.F.R. §§ 25.23(a), 228.23(a), 345.23(a), and 563e.23(a). Examiners may adjust a small institution’s evaluation under the small institution performance criteria, if appropriate, based on qualified investments. See 12 C.F.R. §§ 25.26(a)(1), 228.26(a)(1), 345.26(a)(1), and 563e.26(a)(1). See also Community Reinvestment; Interagency Questions and

institution's assessment area(s) or a broader statewide or regional area that includes the institution's assessment area(s).⁴

Qualified investments are defined as lawful investments, deposits, membership shares or grants that have as their primary purpose community development.⁵ Community development includes, among other things, activities that revitalize or stabilize low- or moderate-income geographies and activities that promote economic development by financing businesses that meet the size specifications in regulations governing the Small Business Administration's small business investment company and development company programs⁶ or have gross annual revenues of \$1 million or less.⁷

Activities that revitalize or stabilize low- or moderate-income geographies must provide direct, long-term benefits to low - or moderate-income individuals in the low- or moderate-income geography.⁸ An activity is considered to promote economic development if it supports permanent job creation, retention, and/or improvement for persons who are currently low- or moderate-income or supports permanent job creation, retention, and/or improvement in low- or moderate-income geographies targeted for redevelopment by Federal, state, local or tribal governments.⁹ Staff will presume that any loan to or investment in a development company or small business investment company promotes economic development.¹⁰

Answers Regarding Community Reinvestment (hereinafter "Qs and As"), 61 Fed. Reg. 54,647, 54,658 (October 21, 1996) (Q and A 1 addressing § __.26(a) (consideration of small institutions' lending-related activities)). Qualified investments may also be considered to determine if a small institution merits an outstanding CRA rating. See 12 C.F.R. 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). See also Q and A 5 addressing § __.26(a), 61 Fed. Reg. at 54,659. The community development test used for wholesale and limited purpose institutions evaluates, *inter alia*, the number and amount of qualified investments. See 12 C.F.R. §§ 25.25(c)(1), 228.25(c)(1), 345.25(c)(1), and 563e.25(c)(1). 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, *inter alia*, qualified investments. See 12 C.F.R. §§ 25.27(f)(1), 228.27(f)(1), 345.27(f)(1), and 563e.27(f)(1).

⁴Wholesale and limited purpose institutions may receive consideration for investments nationwide if they have adequately addressed the needs of their assessment area(s). 12 C.F.R. §§ 25.25(e)(2), 228.25(e)(2), 345.25(e)(2), and 563e.25(e)(2).

⁵12 C.F.R. §§ 25.12(s); 228.12(s); 345.12(s); and 563e.12(r). This letter assumes, without deciding, that financial institutions' investment in the SEnotes would be lawful.

⁶See 13 C.F.R. § 121.301.

⁷12 C.F.R. §§ 25.12(h)(3) and (4), 228.12(h)(3) and (4), 345.12(h)(3) and (4), and 563e.12(g)(3) and (4).

⁸See Q and A 4 addressing §§ __.12(i) and 563e.12(h), 61 Fed. Reg. at 54651.

⁹See Q and A 1 addressing §§ __.12(h)(3) and 563e.12(g)(3), 61 Fed. Reg. at 54650.

¹⁰*Id.*

Thus, in evaluating whether a financial institution's investment in Notes has a primary purpose of community development, examiners will consider the following:

- whether the investment promotes economic development by financing businesses that meet the size eligibility standards specified in the CRA regulation;
- whether the investment supports activities that revitalize or stabilize low- or moderate-income areas such as by supporting permanent job creation, retention, and/or improvement in low- or moderate-income geographies targeted for redevelopment by Federal, state, local or tribal governments; and
- whether an institution's investment would benefit the institution's assessment area(s) or a broader statewide or regional area that includes the institution's assessment area(s).

If you have any further questions concerning this matter, please feel free to contact me or Yvonne McIntire of my staff at (202) 874-5750.

Sincerely,

/s/

Michael Bylsma
Director
Community and Consumer Law Division